

**Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554**

In the Matter of)	
)	
Annual Assessment of the Status of)	MB Docket No. 07-269
Competition in the Market for the)	
Delivery of Video Programming)	
)	
)	
)	
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COMMENTS OF THE INDEPENDENT FILM & TELEVISION ALLIANCE

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July 29, 2009

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Summary

The Independent Film & Television Alliance (“IFTA”) is the trade association for the independent film and television industry representing production and distribution companies worldwide. IFTA hereby submits its comments, together with the data and analysis on the impact of vertical integration on competition in the delivery of video programming contained in the Appendices in response to the pending *Notice of Inquiry: In the Matter of Annual Assessment of the State of Competition in the Market for the Delivery of Programming* in MB Docket No. 07-269 (“Notice” or “NOI”).¹

IFTA’s analysis of the status of competition on the delivery of video programming demonstrates the stark realities faced by independent producers in securing U.S. distribution through network and cable television and the Internet. The accelerated vertical integration of the major studios with network broadcasters, cable operators and now Internet Video on Demand (VOD) service operators over the past decade has resulted in a lack of meaningful competition for *crucial, but scarce* U.S. distribution slots. This lack of competition and domination by the majors has meant that independent programming has been pushed out of network and pay cable, subsisting only on a limited number of basic cable channels. The vast majority of all network and pay cable programming including those shown in prime time viewing hours and repeated on Internet VOD websites is produced by the major conglomerates or their affiliates, leaving little to no room for independent programming from diverse sources. The public also loses out when there is a lack of competition since they have little access to a wide range of programming from a variety of sources outside the major conglomerates and gatekeepers.

¹ *Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming*, Supplemental Notice of Inquiry, MB Docket No. 07-269 (rel. Apr. 9, 2009) (“Supplemental NOI”).

IFTA respectfully requests that as a result of review and consideration of the facts set forth in response to this *Notice*, that the Commission initiates further proceedings regarding the status of competition for *distribution opportunities* for independently supplied programming on television, cable and Internet; the impact of vertical integration on independent program supply; and also evaluate the impact on the American public of the loss in the U.S of independent, diverse programming; and the appropriate measures to respond to these conditions. By taking these steps within its authority, the Commission can act meaningfully to ensure the survival of the independent production community and to provide the public with choices in diverse and engaging video programming.

Background

The Independent Film & Television Alliance (IFTA) is the trade association for the independent film and television industry worldwide. Our nonprofit organization represents more than 150 member companies from 22 countries, consisting of independent production and distribution companies,² sales agents, television companies, studio-affiliated companies and financial institutions engaged in film finance. Collectively, IFTA Members produce over 400 feature films and countless hours of programming annually with U.S. sales revenues of more than \$500 million for 2008. Over the last six years, independent production companies have produced nearly 80% of all U.S. feature films.³ Since 1982, IFTA Members were involved with the financing, production and U.S. and international distribution for 63% of the Academy Award Winning Best Pictures® including *Gandhi*, *Dances with Wolves*, *Braveheart*, *Million Dollar Baby*, *Crash*, *The Departed*, *No Country for Old Men* and *Slumdog Millionaire*.

IFTA is filing Comments in response to this Supplemental Notice to provide information to the Commission regarding the lack of competition in the delivery of video programming. The lack of meaningful distribution slots for video programming has meant that independent programming has been largely eradicated from broadcast and pay cable television, which now subsists only on a limited number of basic channels. IFTA is also concerned that the same lack of competition in the traditional distribution platforms of broadcast and cable television is now migrating to the Internet as vertically integrated companies including major studios, networks and Internet Service Providers (ISPs) begin to control and interlock destination websites which allow for streaming of programming that has already aired on television. These companies are

² IFTA defines “independent” producers and distributors as those companies and individuals apart from the major studios that assume the majority (more than 50%) of the financial risk for production of a film or television program and control its exploitation in the majority of the world. This should be in the main text.

³ See Appendix A: *U.S. Feature Film Production (2003 - 2008) Independent v. Major Studio*. IFTA Analysis of Weekly Production listings published in The Hollywood Reporter and Daily Variety.

also engaging in bundling and tiering of services and programming, which collectively may severely diminish the quality, diversity and selection of video programming available to the public.

Competition in the Market for the Delivery of Video Programming

The Notice seeks data and comment regarding consumers' choices for access to video programming and how these choices have been changed since June 30, 2007 in order to evaluate changes in competition within the video distribution marketplace on an annual basis since that date.⁴ As background for marketplace changes during the time period of June 30, 2007 through June 30, 2009, the Commission may find useful a broader, historical view of delivery of video programming through television, cable and theatrical distribution.

The independent production industry flourished from the 1940s through the early 1990s as a result of several federal judicial and regulatory decisions. Such decisions for the most part barred studios from owning theaters and prohibited them from vertically integrating their production divisions with television distribution and theatrical exhibition. As a result, independent producers were guaranteed fair access to these markets. This benefited both independent companies, who were able to create diverse programming, obtain U.S. distribution and maintain profitable businesses (which in turn funded future production), and the public, who were able to access a wide range of high quality, engaging programming.

However, in the mid-1990s, two major developments severely limited the marketplace choices for independent producers and distributors: (1) the elimination of the Financial Interest / Syndication Rules ("fin/syn rules") and removal of the related consent decrees;⁵ and (2) the

⁴ Supplemental NOI ¶ 3.

⁵ In 1993, the Commission repealed significant portions of the fin/syn rules, scheduled the remaining rules for expiration, and ordered a proceeding six months prior to the scheduled expiration date to give interested parties an opportunity to demonstrate why the Commission should not allow the rules to expire as scheduled. *In the Matter of Evaluation of the Syndication and Financial Interests Rules*, 8 FCC Rcd. 8270 (Sep. 23, 1993). In 1993, a federal district court granted a motion to delete certain antitrust consent judgments against CBS, NBC and ABC. *U.S. v.*

subsequent vertical integration of major studios with the major national broadcast television and cable networks.⁶ These two events led to the elimination of most independent feature films and television programming from broadcast television, including from lucrative primetime viewing hours. The public was left with limited programming because the same five major studio conglomerates that produce their own programming also act as gatekeepers for the majority of U.S. distribution in all media.⁷

The networks claimed that the expiration of the fin/syn rules would create *more* competition,⁸ both by allowing the networks to become producers and because the emerging cable channels would provide outlets for an increased amount of programming. Unfortunately, this has not been the case. In fact, the removal of those regulations, which in essence guaranteed a certain level of competition in video programming distribution, has permitted a rapid acceleration of consolidation, vertically integrating major studios with networks and also with the very cable channels that might otherwise have been new distribution outlets.

This consolidation of production and distribution has allowed the major conglomerates to prefer their own programming and that of affiliates because it is in their best interest to have the least amount of competition in the delivery of video programming. Without government regulation or oversight, U.S. distribution opportunities for independently produced programming have steadily dwindled and in some program categories have disappeared altogether.

The lack of distribution opportunities today for independent programming is evidenced by some glaring statistics. Five major conglomerates now own the national broadcast networks

National Broadcasting Co., Inc., 842 F.Supp. 402 (C.D. Cal 1993). The removal of the consent decrees enabled the revised fin/syn rules to be fully effective. See Mary Einstein, *Media Diversity: Economics, Ownership, and the FCC*, Lawrence Erlbaum, pg. 109-110 (July 15, 2004). The Seventh Circuit upheld the 1993 FCC Order revising the fin/syn rules. *Capital Cities/ABC, Inc., v. FCC*, 29 F.3d 309 (7th Cir. 1994). In its 1995 Order, the FCC determined that the proponents of the fin/syn rules failed to demonstrate why continuation of the rules was justified and ordered elimination of the rules upon publication of the Order. *In Review of the Syndication and Financial Interests Rules Section 73.659-73.663 of the Commission's Rules*, 10 FCC Rcd. 12165 (Sep. 6, 1995).

⁶ See Appendix B: *U.S. Network / Cable Ownership - Fiction Programming Channels*. IFTA analysis of data from *Columbia Journal Review* website (<http://www.cjr.org/resources>) May 11, 2009.

⁷ *Id.*

⁸ *U.S. v. National Broadcasting Co., Inc.*, 842 F.Supp. 402.

and 24 out of 29 of the top cable channels that offer fictional programming,⁹ which are available to over 85% of U.S. cable households.¹⁰ These same companies produce over 80% of all primetime programming,¹¹ and they control 85% of the primetime television market share.¹² Additionally, during the years 2002 – 2008, nearly 100% of the fictional TV series that met the minimum episode requirements for off-network syndication eligibility were produced by the network/major studio conglomerates.¹³ As the major networks have been allowed greater vertical integration, the percentage of independently produced series on the national broadcast networks have declined from over 50% in 1989 (when there were four national networks)¹⁴ to just 5% (on the now five networks) in 2008.¹⁵ This has resulted in these same broadcast networks airing over 70% of their own programming in syndication on basic and pay cable channels;¹⁶ first run television syndication, which was a significant market for independent programming, is now nonexistent.

Impact of Economic Environment on Video Programming Service

These near complete marketplace obstacles have acutely impacted the economic health of the independent film and television industry. In 2007 and 2008, only 3% and 5% respectively of the total fictional TV series aired in network primetime viewing hours were independently

⁹ See Appendix B: *U.S. Network / Cable Ownership - Fiction Programming Channels*. IFTA analysis of data from *Columbia Journal Review* website (<http://www.cjr.org/resources>) May 11, 2009.

¹⁰ IFTA analysis of SNL Kagan data (2008 US cable households, "Top 25 MSOs as of December 2008) on National Cable & Telecommunications Association website (available at <http://www.ncta.com/Stats/TopMSOs.aspx>) and programming listings provided by MSO websites.

¹¹ See Appendix H: Mark Cooper, Ph.D., *The Impact of the Vertically Integrated, Television-Movie Studio Oligopoly on Source Diversity and Independent Production*, Consumer Federation of America, p. 34-35 (2006). IFTA submitted this study to the Commission as part of the official record in a previous filing. See *In the Matter of 2006 Quadrennial Regulatory Review-Review of the Commission's Broadcast Ownership Rules and Other Rules Adopted Pursuant to Section 202 of the Telecommunications Act of 1996, et seq.*, MB Docket No. 06-1211 (Oct. 23, 2006).

¹² See Appendix H: Mark Cooper, Ph.D., *The Impact of the Vertically Integrated, Television-Movie Studio Oligopoly on Source Diversity and Independent Production*, Consumer Federation of America, p. 29 (2006).

¹³ See Appendix C: *Fiction TV Series Broadcast on U.S. Network Television (2002 - 2008) Analysis of Off Network Syndication Potential Independent Series v. Majors Series*. IFTA analysis of data from Baseline Studio Systems, the Internet Movie database (www.imdb.com).

¹⁴ See Appendix H: Mark Cooper, Ph.D., *The Impact of the Vertically Integrated, Television-Movie Studio Oligopoly on Source Diversity and Independent Production*, Consumer Federation of America p. 34-35 (2006).

¹⁵ See Appendix D: *Fiction Series Shown on US Television: 2002 – 2008 Independent v. Major Studio*. IFTA analysis of data from Baseline Studio Systems, the Internet Movie database (www.imdb.com).

¹⁶ See Appendix H: Mark Cooper, Ph.D., *The Impact of the Vertically Integrated, Television-Movie Studio Oligopoly on Source Diversity and Independent Production*, Consumer Federation of America, p. 38 (2006).

produced.¹⁷ Such minimal television distribution opportunities for independent programming during the prime time viewing hours of 8-11PM means those independent producers are no longer able to fund the production costs of this type of programming. It also means that almost all of the fictional television series aired during that time originated from very few sources, leaving the public with limited perspectives and choices during the most popular television viewing hours.

Those independent producers seeking distribution for their *feature* films,¹⁸ and the public that may want to view these films on network television, are also out of luck. In a sampling of certain weeks from 2002-2008, just 10% of *feature* films on network TV were from independent producers.¹⁹ For the sampling of programming weeks in 2007, only 1 independent feature film was aired by U.S. networks and during the sample week in 2008 none was aired.²⁰ In both 2007 and 2008, only 22% of the total network and cable television slots for feature films were occupied by independently produced films.²¹

In the case of programming designed specifically for television distribution, such as “Movies of the Week” (MOWs) or television series, U.S. distribution is absolutely essential in order to finance and produce the programming. Without a U.S. distribution slot in broadcast or cable television, independent programming intended for this type of distribution will simply not be made. Even if the program is not specifically targeted for U.S. distribution, securing a U.S. license may determine whether and how much production financing can be secured from other sources and whether revenues from foreign markets are available to the producer.

¹⁷ See Appendix D: *Fiction Series Shown on US Television: 2002 – 2008 Independent v. Major Studio*. IFTA analysis of data from Baseline Studio Systems, the Internet Movie database (www.imdb.com).

¹⁸ Feature films do not include so called “Movies of the Week”.

¹⁹ See Appendix E: *Feature Films Shown on U.S. Television, Independent v. Major Studio*. Sample Weeks from February & August Schedule 2002/2003 to 2007/2008; Seasons Comparison with 1993 / 1994 Season. IFTA Analysis of U.S. Television Programming from Baseline Studio Systems and the Internet Movie database (www.imdb.com).

²⁰ *Id.*

²¹ *Id.*

The economic impact of this marketplace consolidation is not solely limited to loss of distribution options, but also alters the terms of the licenses for independent producers who *are* able to secure distribution. When licensing independent programming, networks and cable operators have almost total bargaining power for their coveted distribution slots and often contractually require independent producers to fund the development and/or production of pilots on a loss basis. More disturbingly, these operators may demand an equity position in the program in exchange for airing it in prime time. Often times, the programming acquired is relicensed or shifted to other channels of the conglomerates' affiliated companies, which negotiate the license fee among each other, resulting in reduced compensation for the producer.²²

In today's marketplace, the major network and cable companies possess unlimited power in their selection and acquisition of programming. In most instances, the networks and major cable channels rely almost entirely on programs that are produced by their affiliated studios. Insofar as independent programming is acquired for broadcast or initial transmission, they are routinely acquired for license fees that are far below the cost of production; for the same basic price, providers typically also must convey rights for additional distribution platforms (including domestic broadcast, video on demand, pay per view, etc.). For example, rights to movies of the week that are produced for certain basic cable channels typically are licensed by the cable service for \$750,000 for a film with a production budget contractually required to be in excess of \$1.2 million; the same contracts today frequently require that all other domestic U.S. television delivery rights are included without additional fees.

U.S. networks and cable operators may also require granting lengthy "holdbacks" (i.e., agreement not to release elsewhere), that prevent distribution of the programming in other

²² See Matthew Belloni, *Power of Attorneys: A Tenacious Hollywood Reporter is More Important than Ever (Free Advice)*, The Hollywood Reporter, p. 18 (July 3, 2009).

countries or in other media, including Internet distribution rights. These conglomerates may also require a grant of all or a portion of the international distribution rights (which for MOWs is the only revenue that will make up the deficit between the production budget and the U.S. television or cable license fee paid by the network or cable operator).

If a program is acquired by a network, it may be aired during a less attractive time slot. For instance, of the 18 independently produced TV series that aired on network TV during 2002-2008, 9 were given slots on Sunday, Monday or Friday nights, and the remaining were put up against such powerhouse programs as *The West Wing*, *CSI*, *Law and Order* and *Survivor*.²³ Further, these programs are provided a limited and insufficient timeframe to build an audience, and then are required to forego syndication rights in order for the conglomerates to repurpose it on their affiliated cable channels.

With respect to reality TV programming, over the past six years, only 35% of all reality shows on network, basic and pay cable stations were independently produced.²⁴ Borrowing from a well-known story line, if the extreme hardships faced by independent producers were featured on a “reality TV” show, the show would document many companies struggling to survive on food slivers on this economic desert island. Many independent companies have already been “voted off the island” and companies such as Carsey-Werner (*The Cosby Show* and *Roseanne*), Cannell Studios (*21 Jump Street*), Witt Thomas Harris (*The Golden Girls*), Black / Marlens Company (*The Wonder Years*) are no longer producing network television series while Spelling Entertainment (*Beverly Hills 90210*) has become a production label at CBS.

²³ See Appendix F: *Timeslots of Independent Fiction Series on TV (2002-2009)*. IFTA analysis of data in TV Guide weekly publications.

²⁴ See Appendix G: *Reality Series Shown on US Television: 2002 – 2008, Independent v. Major Studio*. IFTA analysis of TV Guide listings using data from Baseline Studio Systems and IMDB.

Impact of Video Services on Broadband Deployment

The Notice seeks information on the extent to which the availability of video over the Internet through services that require high bandwidth, such as YouTube, iTunes and Amazon, has stimulated consumer demand for high speed broadband service and vice versa.²⁵ The public's interest is best served and consumer demand for programming and high speed broadband services are best stimulated by the availability of the widest possible selection of programming from many diverse sources.

The lack of competition for programming and distribution slots amongst the conglomerates and gatekeepers may quickly result in unequal access to Internet distribution for independent producers and severely limit the types of programming to which the public has access for the best viewing or downloading experience.²⁶ For example, video programming that is tiered, bundled or offered exclusively by cable operators or ISPs through premium high speed services may NOT include independently supplied programming; or programming supplied through independent (non-major owned) services may be assigned a "slow lane" by cable operators and ISPs who clearly prefer that their own or affiliated product for delivery via "high speed" lanes.

More troubling today is the creation of a few "go to" sites with significant marketing and advertising support that are focused on network television programming (little of which is independent) or are limited to major studios' entertainment offerings. For example, Time Warner's "TV Everywhere" initiative recently announced a trial partnership with one of the largest U.S. broadband provider, Comcast. The economic incentives for Comcast to promote this service to the detriment of others it might carry cannot be discounted. Comcast has also

²⁵ Supplemental NOI ¶ 15.

²⁶ See Appendix A: *U.S. Feature Film Production (2003 - 2008) Independent v. Major Studio*. IFTA Analysis of Weekly Production listings published in The Hollywood Reporter and Daily Variety.

agreed to pay a carriage fee for Disney's ESPN 360 broadband service.²⁷ The stage is being set for other aggregate content providers to follow suit and, through exclusive carriage deals, to ultimately create new distribution platforms to which independents will be denied equal access.

Other key sites have a low level of participation from independents. In general, these sites are unable or unwilling to deal directly with smaller suppliers, preferring to deal with aggregation companies. A producer may receive far less when licensing through a middleman than if dealing directly with the cable operator or ISP because the aggregator receives a portion of the revenue from any programming for which it secures U.S. distribution. For example, it has been reported that Amazon, iTunes, and other destination websites have not been able or willing to take independent programming directly from smaller companies, and that they may even ration the number of titles that come through their own affiliate aggregator.

Even if Internet distribution for video programming is secured, potential revenues from "Internet VOD," including programming distributed via the Internet, high speed broadband or IPTV does not meaningfully contribute to funding or recouping production costs. So while entertainment programming may drive broadband deployment, Internet distribution does not drive production nor is it an alternative to traditional distribution²⁸. This untenable situation has led to concern that independents will not be able to participate in the Internet VOD marketplace on equal footing in order to generate any significant revenue or contribute to funding production costs. Insofar as the content choices on the Internet continue to mimic traditional television, with its now anemic selection of programming, the public's interest in broadband availability will be limited as well.

²⁷ Georg Szalai, *There's a Web of Differing Opinions About What Comes Next in Online Video Business*, The Hollywood Reporter (July 2, 2009).

²⁸ John Flahive, *Where's the profit in online distribution?*, Screen Daily (July 23, 2009) (available at <http://www.screendaily.com/news/opinion/wheres-the-profit-in-online-distribution/5003861.article>).

Web-Based Internet Video Competition

The NOI seeks comments on whether the streaming of traditional television episodes on the Web has impacted consumers' viewing preferences.²⁹ It is important to note that any consumer migration to the Internet in order to stream network programs that was missed when originally distributed on television or cable will not resolve the lack of distribution slots for independent programming nor does it create new programming choices for consumers. The major conglomerates and ISP gatekeepers provide little or no access for independents to the most lucrative parts of today's marketplace – network primetime and syndication, and they provide no opportunities for independents on vertically integrated or controlled Internet services such as Hulu.com or other “destination” websites. On Hulu.com, which is partially owned by Fox, NBC (and Disney as of May 1, 2009),³⁰ only 32% of the feature films offered to the public on Hulu.com were independently produced. Fully 45% of these independently produced feature films are from two companies - Lionsgate and First Look Studios, both IFTA Members - sometimes considered “big independents” or mini studios because of their size, production budgets, and licensing arrangements. Even this percentage will decrease dramatically once Disney adds its feature films to Hulu.com's offerings.

As the NOI acknowledges,³¹ “catch-up TV” websites such as www.abc.com ***only repeat what has already aired on the ABC Network.*** So if independent video programming is shut out of network television, then it is automatically shut out of the Internet distribution opportunities that may follow for network aired programming. Adding insult to injury, independent rights holders may not be compensated with upfront license fees or share in any advertising revenues associated with the streaming of their programming on these “catch-up TV” sites.

²⁹ Supplemental NOI ¶ 42.

³⁰ See Appendix B: U.S. Network / Cable Ownership - Fiction Programming Channels. IFTA analysis of data from *Columbia Journal Review* website (<http://www.cjr.org/resources>) May 11, 2009.

³¹ Supplemental NOI ¶ 42.

Initiatives such as “TV Everywhere” do not address and indeed further exacerbate the problems of lack of access and competition in video programming since the programming offered on destination sites will be the same programming of the underlying cable service. Similar to catch-up TV, these websites will only repeat the program that was lucky enough to secure a network or cable television slot in the first place.

Content Protection and Digital Rights Management

The NOI also asks for an update on content protection technologies that are available to protect against unauthorized copying and redistribution of digital media.³² There are no technologies that are 100% successful in preventing unauthorized use of video programming, but there are many that can be employed to reduce the amount of unauthorized use. Such technologies allow for identification, monitoring, reporting, notice and takedown, spoofing and employing other countermeasures as the programming is exploited across all digital platforms. However, *the best tool to address piracy is making legitimate copies available to the public on legal websites and services which adequately compensate producers for their investment in the content.* To this end, it is increasingly important that independent producers utilize identification systems that protect and monitor their programming in a digital environment and thus allow the programming to be exploited legitimately across all digital platforms.

Identification systems such as the ISO adopted International Standard Audio-Visual Number (ISAN)³³, watermarking and fingerprinting allow for the collection and use of “metadata” in connection with the distribution of the programming. The “metadata” or information describing the film such as writer, director, cast, year of production, version, format, and other information is embedded in the digital file of the program and ensures that the

³² Supplemental NOI ¶ 27.

³³ IFTA is an ISO approved registration agency for ISAN.

programming can be digitally identified (and the producer compensated in accordance with contract or statute) when the digital copy is exploited. In a digital environment, voluntary use of product identification technologies also reduces the transaction costs involved in the “intake” of programming into a distribution platform and calculating compensation for its exploitation; providing such metadata may encourage large aggregators and destination websites to provide a platform and equivalent compensation for independent programming. Watermarking and fingerprinting technology are used in connection with identification to compare legitimate files to illegal files and also to enable quicker notice and takedown of infringing copies utilizing such automated protection systems as You Tube’s Content Identification Program.³⁴

Conclusion

Vertical integration of the television, cable and now Internet distribution and the resulting lack of competition among the major conglomerates have resulted in a Grand Canyon sized gap between U.S. distribution slots for independent programming versus major studio programming. This wide gorge threatens independent producers’ ability to create or license copyrighted programming *or even to remain in business*. The internet, once hailed as the promise land for those displaced from network and cable television, is showing signs of vertical integration and lack of competition. It is not only the independent producers and distributors who suffer the consequences – the American public is also left without the diverse programming that had been an integral part of our culture since television was introduced in our homes. The public and independent companies deserve more representation and diversity on major media platforms, and the FCC should lead the way in that initiative. It is in the interest of the American public to have meaningful choice and access to a wide range of programming produced by many sources including those sources *independent of and outside* the major conglomerates.

³⁴ See www.youtube.com/videocontentid

IFTA respectfully requests that as a result of review and consideration of the facts set forth in response to this *Notice*, the Commission initiate further proceedings regarding the status of competition for *distribution opportunities* for independently supplied programming on television, cable and Internet; the impact of vertical integration on independent program supply; the impact on the American public of the loss in the U.S of independent, diverse programming; and the appropriate measures to respond to these conditions. By taking these steps within its authority, the Commission can act meaningfully to ensure the survival of the independent production community and to provide the public with choices in diverse and engaging video programming.

Respectfully submitted,
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Appendix A

U.S. Feature Film Production (2003 - 2008) Independent v. Major Studio

	Independents		Majors		Total
	#	%	#	%	#
2008	338	80%	82	20%	420
2007	501	81%	121	19%	622
2006	415	82%	89	18%	504
2005	468	80%	116	20%	584
2004	484	86%	79	14%	563
2003	263	69%	117	31%	380
6yr AVG	412	80%	101	20%	512

* Source: Weekly production listings published in the Hollywood Reporter and Daily Variety.

Appendix B

U.S. Network / Cable Ownership - Fiction Programming Channels

Source: Columbia Journal Review website (<http://www.cjr.org/resources>) May 11, 2009

National Amusements

CBS

Broadcast Television

- CBS TV Network
- CW Network (50/50 w/ Warner Bros.)

Cable Television

- **Showtime**
- **The Movie Channel**
- **FLIX**

Internet

- CBS.com
- CW Video

Viacom / Paramount

Cable Television

- MTV
- **Spike**
- **BET**
- **Comedy Central**

Internet

- BET.com
- ComedyCentral.com
- Spike.com

NBC Universal

Broadcast Television

- [NBC](#) TV Network
- [Telemundo](#)

Cable Television

- **A&E** (partial)
- **The History Channel** (partial)
- **Bravo**
- **Oxygen**
- **Sci Fi Channel**
- **The Sundance Channel**
- **USA Network**

Internet

- Hulu.com
- NBC.com
- USA Network Online
- BravoTV.com

Fiction programming Cable
Channels in **Bold**

Time Warner (Warner Bros.)

Broadcast Television

- CW (50% with [CBS](#))

Cable Television

- **HBO**
- **Cinemax**
- Cartoon Network
- **TBS**
- **TNT**
- **TCM**

Internet

- AOL
- Road Runner
- CW Video
- TBS.com
- TNT.tv

The Walt Disney Corporation

Broadcast Television

- ABC Network

Cable Television

- **ABC Family**
- **Disney Channel**
- Toon Disney
- SOAPnet
- **Lifetime Network** (partial)
- **A&E** (partial)
- **The History Channel** (partial)

Internet

- ABC.com
- Hulu.com
- Disney Online
- ABCFamily.com

News Corp (FOX)

Broadcast Television

- Fox Broadcasting Company

Cable Television

- **Fox Movie Channel**
- **FX**

Internet

- Hulu.com
- MySpace
- FOX.com

Appendix C

Fiction TV Series Broadcast on U.S. Network Television (2002 - 2008)

Analysis of Off Network Syndication Potential *

Independent Series v. Majors Series

	<u>Independents</u>		<u>Majors</u>	
Total Series on TV	17		333	
Average Seasons	1		2	
Average Episodes	21		51	
Median Seasons	1		1	
Median Episodes	10		19	
Upper Bound (Seasons)	5		20	
Lower Bound (Seasons)	1		1	
Upper Bound (Episodes)	91		441	
Lower Bound (Episodes)	6		1	
# Continuing Series	4		84	
<i>Syndication Qualified*:</i>				
> 80 episodes (1/2 hr series)	1	6%	35	11%
> 50 episodes (1 hr series)	0	0%	48	14%
Total # Series w/ req. eps	1	6%	83	25%

Independents

# of Season Series Lasted	1	2	3	4	5	6	7	8 >
% That Last X Seasons	78%	17%	0%	0%	6%	0%	0%	0%
SYNDICATION QUALIFIED								

Majors

# of Season Series Lasted	1	2	3	4	5	6	7	8 >
% That Last X Seasons	54%	15%	5%	7%	4%	5%	2%	8%
SYNDICATION QUALIFIED								

Source: IFTA analysis of data from Baseline Studio Systems and IMDB.

* Note: In order for a fiction series to qualify for the U.S. syndication market, business practice requires a minimum number of episodes to be produced and broadcast on network television: half hour series - 80 episodes; one hour series - 50 episodes.

Appendix D

Fiction Series Shown on US Television: 2002 - 2008

Independent v. Major Studio

Number of Series

	Network		Basic Cable		Pay Cable		Total All TV Venues	
	<i>Indies</i>	<i>Majors</i>	<i>Indies</i>	<i>Majors</i>	<i>Indies</i>	<i>Majors</i>	<i>Indies</i>	<i>Majors</i>
2007/08	7	123	23	72	6	18	36	213
2006/07	3	91	18	56	3	15	24	162
2005/06	17	100	11	38	2	13	30	151
2004/05	5	105	11	36	3	14	19	155
2003/04	9	107	11	27	2	18	22	152
2002/03	12	106	9	18	4	15	25	139
6yr AVG	9	105	14	41	3	16	26	162

Percentage of Total

	Network		Basic Cable		Pay Cable		Total All TV Venues	
	<i>Indies</i>	<i>Majors</i>	<i>Indies</i>	<i>Majors</i>	<i>Indies</i>	<i>Majors</i>	<i>Indies</i>	<i>Majors</i>
2007/08	5%	95%	24%	76%	25%	75%	14%	86%
2006/07	3%	97%	24%	76%	17%	83%	13%	87%
2005/06	15%	85%	22%	78%	13%	87%	17%	83%
2004/05	5%	95%	23%	77%	18%	82%	11%	89%
2003/04	8%	92%	29%	71%	10%	90%	13%	87%
2002/03	10%	90%	33%	67%	21%	79%	15%	85%
6yr AVG	8%	92%	26%	74%	17%	83%	14%	86%

Source: IFTA analysis of TV Guide listings using data from Baseline Studio Systems and IMDB.

Appendix E

Feature Films Shown on U.S. Television

Independent v. Major Studio

Sample Weeks from February & August Schedule

2002/2003 to 2007/2008 Seasons Comparison with 1993 / 1994 Season

Number of Films

	Network		Basic Cable		Pay Cable		Total All TV Venues	
	<i>Indies</i>	<i>Majors</i>	<i>Indies</i>	<i>Majors</i>	<i>Indies</i>	<i>Majors</i>	<i>Indies</i>	<i>Majors</i>
2007/08	0	14	78	244	35	132	113	390
2006/07	1	15	80	273	44	155	125	443
2005/06	1	17	80	248	38	151	119	416
2004/05	0	0	77	233	36	115	113	348
2003/04	2	8	89	270	40	115	131	393
2002/03	1	4	118	239	33	117	152	360
6-yr AVG	1	10	87	251	38	131	126	392
1993/94	18	32	128	304	236	308	382	644

Percentage of Total

	Network		Basic Cable		Pay Cable		Total All TV Venues	
	<i>Indies</i>	<i>Majors</i>	<i>Indies</i>	<i>Majors</i>	<i>Indies</i>	<i>Majors</i>	<i>Indies</i>	<i>Majors</i>
2007/08	0%	100%	24%	76%	21%	79%	22%	78%
2006/07	6%	94%	23%	77%	22%	78%	22%	78%
2005/06	6%	94%	24%	76%	20%	80%	22%	78%
2004/05	n.a.	n.a.	25%	75%	24%	76%	25%	75%
2003/04	20%	80%	25%	75%	26%	74%	25%	75%
2002/03	20%	80%	33%	67%	22%	78%	30%	70%
6-yr AVG	10%	90%	26%	74%	22%	78%	24%	76%
1993/94	36%	64%	30%	70%	43%	57%	37%	63%

Source: IFTA analysis of TV Guide listings using data from Baseline Studio Systems and IMDB.

Appendix F

Timeslots of Independent Fiction Series on TV (2002-2009)

General Information				Competition				
<i>Series Name</i>	<i>Day</i>	<i>Time Slot</i>	<i>Year</i>	<i>ABC</i>	<i>CBS</i>	<i>The CW</i>	<i>NBC</i>	<i>FOX</i>
Greek	Fri	9:00 PM	2007	GREEK	Jericho	Friday Night Smackdown	Las Vegas	Standoff
The Help	Fri	9:30 PM	2004	Life with Bonnie	JAG	THE HELP	Dateline NBC	Test the Nation 2
Runaway	Mon	9:00 PM	2006	Lost	Two & a Half Men	RUNAWAY	Heroes	Vanished
Grounded for Life	Mon	8:30 PM	2001	MNF	Yes, Dear	7th Heaven	Weakest Link	GROUNDING FOR LIFE
Surviving Suburbia	Mon	9:30 PM	2009	No data	No data	No data	No data	No data
Sports Action Team	Sun	9:00 PM	2006	Desperate Housewives	Cold Case	America's Next Top Model	SPORTS ACTION TEAM	Family Guy
Valentine	Sun	8:00 PM	2008	Extreme Makeover: Home Edition	Amazing Race 13	VALENTINE	Special / LP	Simpsons / King of the Hill
Quarterlife	Sun	9:00 PM	2008	Oprah's Big Give	Cold Case	Girlfriends	QUARTERLIFE	Family Guy / Unhitched
The Days	Sun	10:00 PM	2004	THE DAYS	Dodson's Journey	News	Crossing Jordan	News
Fear Itself	Thur	10:00 PM	2008	Hopkins	Swingtown	LP	FEAR ITSELF	LP
The O'Keefes	Thur	8:30 PM	2003	Wheel of Fortune	CSI: Miami	OKEEFES	Will & Grace	30 Seconds to Fame
Drew Carey's Green Screen	Thur	8:30 PM	2004	No data	Survivor: Vanuatu - Islands of Fire	DREW CAREYS GREEN SCREEN	Will & Grace	The O.C.
Love, Inc	Thur	9:30 PM	2005	Primetime	CSI: Crime Scene Investigation	No data	The Apprentice	Reunion
3 Lbs.	Tues	10:00 PM	2006	Show Me the Money	3 LBS.	LP	Law and Order SVU	LP
New Amsterdam	Tues	9:00 PM	2008	Jim / Carpoolers	Big Brother 9	One Tree Hill	Biggest Loser	NEW AMSTERDAM
Life With Bonnie	Tues	8:30 PM	2002	LIFE WITH BONNIE	JAG	Gilmore Girls	Cosby Show: A Look Back	Grounded for Life
Twilight Zone	Wed	9:00 PM	2002	The Bachelor	Big Brother 3	Blue Streak	West Wing	Fastlane

LP = Local Programming

Source: TV Guide

Appendix G

Reality Series Shown on US Television: 2002 - 2008 Independent v. Major Studio

Number of Series

	Network		Basic Cable		Pay Cable		Total All TV Venues	
	<i>Indies</i>	<i>Majors</i>	<i>Indies</i>	<i>Majors</i>	<i>Indies</i>	<i>Majors</i>	<i>Indies</i>	<i>Majors</i>
2007/08	21	46	57	61	2	3	80	110
2006/07	14	32	25	17	0	4	39	53
2005/06	16	31	13	37	1	1	30	69
2004/05	20	44	34	44	0	4	54	92
2003/04	13	33	16	26	0	4	29	63
2002/03	10	35	10	11	0	3	20	49
6yr AVG	16	37	26	33	1	3	42	73

Percentage of Total

	Network		Basic Cable		Pay Cable		Total All TV Venues	
	<i>Indies</i>	<i>Majors</i>	<i>Indies</i>	<i>Majors</i>	<i>Indies</i>	<i>Majors</i>	<i>Indies</i>	<i>Majors</i>
2007/08	31%	69%	48%	52%	40%	60%	42%	58%
2006/07	30%	70%	60%	40%	0%	100%	42%	58%
2005/06	34%	66%	26%	74%	50%	50%	30%	70%
2004/05	31%	69%	44%	56%	0%	100%	37%	63%
2003/04	28%	72%	38%	62%	0%	100%	32%	68%
2002/03	22%	78%	48%	52%	0%	100%	29%	71%
6yr AVG	30%	70%	44%	56%	15%	85%	35%	65%

Source: IFTA analysis of TV Guide listings using data from Baseline Studio Systems and IMDB.

Appendix H

THE IMPACT OF THE VERTICALLY INTEGRATED, TELEVISION-MOVIE STUDIO OLIGOPOLY ON SOURCE DIVERSITY AND INDEPENDENT PRODUCTION

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I. INTRODUCTION & OVERVIEW

THE EMERGENCE OF A VERTICALLY INTEGRATED OLIGOPOLY IN TELEVISION

This paper examines the impact of three major policy changes in the early and mid-1990s on the production and distribution of video content, primarily broadcast television programming in America: the repeal of the Financial Interest / Syndication rules and the enactment of both the Cable Act of 1992 and the Telecommunications Act of 1996.³⁵ The paper also considers how the production and distribution of movie programming for cable and theatrical release were affected. It shows that these policy changes led to the formation of a vertically integrated oligopoly in television entertainment and a dramatic shrinkage of the role of independent producers of content. The policy changes and resulting alterations in market structure and behavior were not limited to the broadcast sector, however. They also affected the syndication market, cable television and theatrical movies because prime time programming plays a critical role in the overall video entertainment product space. If not amended, these same policy changes could have a major impact upon the ability of independents to offer product through the Internet and other developing digital platforms, including the rapidly approaching digital multi-cast channels.

Over the course of a decade, the content aired on prime time network television, TV syndication, basic and pay cable channels, and theatrical movies came to be dominated by a handful of vertically integrated entities.³⁶ Dozens of independent entities that produced video content were replaced by a handful of firms that own major movie studios and television

³⁵ See Chapter III for a discussion of these policy changes and their impact on industry structure.

³⁶ See Chapter IV for a detailed description of the changes in program sources that followed the policy and structural changes in the industry.

production units, hold multiple broadcast licenses and own the dominant cable networks. The role of independent producers has been squeezed across all distribution platforms.

By two widely accepted economic measures of market concentration, the Herfindahl-Hirschman Index (HHI) and the market share of the top four firms (the 4 Firm Concentration Ratio or CR-4), the video market has become a concentrated, vertically integrated, tight oligopoly. As a result, this oligopoly engages in a number of predatory business practices that both limit competition from independents and deprive the public of new, fresh voices. They foreclose the market to independents by leveraging their vertical market power and by self-supplying product. They exercise their market power as buyers of content (monopsony power) with two practices that are especially damaging to competition from independent producers. The first is that networks often demand that they be given an equity participation in an independently developed television series in order for it to be placed on the primetime schedule. The second is that basic cable channels owned by members of the oligopoly will not pay license fees that are commensurate with the production values and the scope of licensed rights they demand in independently produced TV movies.

EFFECT OF THE VERTICALLY INTEGRATED OLIGOPOLY ON THE TELEVISION MARKET

Fifteen years ago, theatrical movie studios and broadcast television were almost entirely separate while cable television was just developing as a primary outlet. In each of these markets, there was a substantial independent sector. Major studios provided about one third of product shown on network prime time television while the networks themselves accounted for just 15%. Non-major studios, known as “independents,” supplied nearly one

half. One set of independents sold movies to broadcasters. Another set sold series and other programming. A few produced and sold both. Vertical integration has changed that situation.

The vertically integrated major studios and broadcasters now account for over 75% of broadcast prime time television programming while independents account for less than 20%. The few independents that get on prime time television produce reality shows, not scripted programming. As a result, independents have been virtually shut out of the lucrative syndication market, now accounting for just 18% of all first run syndication programming hours and none of the programming hours for shows that have gone into syndication over the last two years.

The economic terrain of cable television has also changed for independents. The vertically integrated media companies own 24 of the top 25 cable channels. The independents' share of pay cable programming also continues to decline as a percentage of programming, dropping by some 15% since the late nineties. Independent product was also squeezed out of syndication. Independent product is increasingly consigned to the far less visible and less financially rewarding basic cable channels where license fees are much lower and in many cases inadequate to cover production costs. Additionally, product placed on basic cable does not have the same potential to realize foreign sales that pay cable product enjoys.

The business practices used to accomplish this dramatic shift in the flow of content in the video product space exhibit characteristics that clearly fit the pattern of abuse of market.³⁷ By controlling distribution and vertically integrating into production, five of the dominant broadcasters have become gatekeepers who favor their affiliated content, restrict access of

³⁷ See Chapter V for a discussion of these business practices and their effect on source diversity and independent production of video content.

independents to the market, and impose onerous terms and conditions on independent producers that have further shrunk the sector.

While it is extremely difficult to assess the impact of the changes in the industry on quality, there is no doubt that the independent sector was a consistent source of innovative and high quality content in both the TV series and movies categories prior to the changes in policy.³⁸ Measured by both popularity and awards, the independents more than hold their own when given a chance to reach the public. This quantitative evidence reinforces the celebrated anecdotal evidence – shows like *All in the Family* and *Cosby* – frequently offered about the importance of independent production. It is quite clear that the elimination of independents from the high value TV product spaces – prime time and premium cable – cannot be attributed to poor quality of product. It is more readily attributed to changes in the structure of the industry and the business practices of the dominant, vertically integrated oligopoly.

The key elements of the video entertainment product space fit a pattern that the literature on industrial organization describes as the exercise and abuse of market power. These elements include:

Market Structure and Market Power

- Market shares that have risen to the level traditionally defined as a source of concern about concentration setting the stage for the abuse of market power.
- Substantial barriers to entry in the industry.
- A history of anticompetitive practices.

Vertical Integration

³⁸ See Chapter VI for a discussion of quality.

- Barriers to entry increased by vertical integration.
- The foreclosure of markets to unaffiliated producers through favoritism of affiliated upstream production and the subsequent exit of upstream product suppliers from the market.
- Parallelism and reciprocity among the dominant firms in the oligopoly.
- A rush to integrate and concentrate across the sector.

Monopsony (buyer) Power over independent producers.

- The imposition of prices that squeeze unaffiliated producers and terms that shift risk onto those producers.
- Indications of a decline of quality in product attendant on the abuse of monopsony power.
- Flooding of downstream outlets with integrated product.

POLICY IMPLICATIONS OF CONSOLIDATION AND INTEGRATION

The swift and massive horizontal consolidation and vertical integration in the industry raises a number of concerns. The analysis of the economic impact of horizontal concentration and vertical integration can be found across many areas of economic activity, but the unique nature and role of video entertainment raises additional, perhaps even greater concerns in non-economic areas. Television and movies, the former in particular, are fundamental to democratic discourse. Television is the dominant medium in terms of time spent on entertainment and news and information gathering.³⁹ It is overwhelmingly the choice for national campaign advertising. Entertainment on television can be cultural, educational or political. Theatrical releases have a prominent role in the public discourse as well, which films such as *Crash* and *The Passion of the Christ* have demonstrated in recent years.

³⁹ Cooper Mark, *Media Ownership and Democracy in the Digital Information Age* (Palo Alto: Stanford Law School Center for Internet and Society, 2003).

Television and movies play an important part in the marketplace of ideas. A nation that prides itself on freedom of speech and diversity while simultaneously issuing exclusive licenses to private firms to broadcast content faces a dilemma. The issuance of a handful of broadcast licenses in each market in America creates a privileged class of speakers through government action. Local governments issue franchises to cable TV operators, which are even more scarce than broadcast licenses on a city-by-city, county-by-county basis.

How one promotes diversity with such a small number of electronic voices, without dictating what content broadcasters should air, becomes a major source of concern. If those very valuable and powerful government-granted platforms for reaching the public become the core of a tight oligopoly that dominates other areas of expression, the concern is compounded.

If dictating content is ruled out by First Amendment free speech concerns, but policy makers continue to strive for diversity, then the primary option is to build media market structures that disperse the opportunity to speak as much as possible within the confines of the granting of licenses and franchises. The principle on which this approach stands is simple. By ensuring a wider opportunity to put content before the public, diversity and discourse are stimulated without dictating the substance of the content supplied.

POLICIES TO PROMOTE DIVERSITY

For much of the twentieth century, the Congress and the Federal Communications Commission pursued this goal of diversity by simultaneously dispersing ownership of production and distribution of content. The number of media outlets that could be owned by a single entity was restricted both within a market (the local television multiple ownership

rule)⁴⁰ and across the nation (a national cap) by the national television multiple ownership rule.⁴¹ The amount of content aired in prime time that any given network could own was limited as well by the Financial Interest and Syndication Rules (Fin-Syn) and the Prime Time Access Rules.⁴² Similarly, consent decrees in cases brought by the Department of Justice mirrored the Fin-Syn rules.⁴³ Other FCC rules prevented Broadcast license holders from owning other types of media outlets – e.g. newspapers and cable TV systems (cross-ownership limits)⁴⁴ -- and restricted their ability to engage in cross-media ownership (e.g. radio).⁴⁵ The result was a substantial dispersion of ownership of content.

In the 1990s, the two primary policies to promote diversity of ownership of content in broadcasting were eliminated or cut back. The Financial Interest and Syndication Rules (Fin-Syn) that governed prime time programming were allowed to expire and the consent decree was also vacated – allowing broadcasters to own as much programming as they wanted. The limits on multiple station ownership were relaxed – allowing them to own two stations in the nation’s largest and most important markets. A third policy also gave broadcasters the right

⁴⁰ 47 C.F. R. 73.355(b), the duopoly rule, lifted the ban on multiple station ownership, but 47 C.F.R. 73.658(g), the dual network rule, restricted the combinations of television stations, to disallow dual or multiple network ownership that involves a combination between ABC, CBS, Fox, or NBC. Citations are to the rules currently being reviewed, which generally relaxed the restrictions on cross ownership in the 1990s and are the latest in the evolving regulatory structure.

⁴¹ 47 C.F. R. s 73.3555(e)

⁴² The two rules have always been closely linked see Amendment of Part 73 of the Commission’s Rules and Regulations with Respect to Competition and Responsibility in Network Television Broadcasting, 23, FCC 2d 282 (1970). Amendment of Part 73 of the Commission’s Syndication and Financial Interest Rule, 47 FR 32959 (1982), as they were in the court case that led to their ultimate expiration, see *Shurz Communication Inc. v. FCC* 982 F. 2d 1043, 1049 (7th Cir. 1992).

⁴³ Identical consent decrees were entered against the three major networks, which followed the Fin-Syn rules closely. These were vacated when in the early 1990s, as the Fin-Syn rules were allowed to expire...

⁴⁴ 47 C.F. R. s 73.3555(d), cross-ownership of broadcast states and newspapers, prohibits the common ownership of a daily newspaper and a broadcast station in the same market.

⁴⁵ 47 C.F.R. 73.3555(c), the radio-television cross –ownership rule, limits the number of TV and radio licenses that can be held within a market.

to carriage on cable systems (must-carry/retransmission).⁴⁶ The terrain of the American media landscape was dramatically altered by these policy changes as the broadcasters moved quickly to use these three new sources of leverage in the video market.

Whether or not Congress anticipated the powerful effect that the policy changes of the 1990s would have on diversity of ownership of programming is unclear. Although the FCC has created records on these issues in its proceedings subsequent to the changes in policy, the courts have remanded several of its rules,⁴⁷ leaving their regulatory status in flux and Congress has included a provision that requires frequent review of the rules.⁴⁸

The FCC continues to have the authority to implement restrictions on media ownership to accomplish the goals that Congress has set in legislating media policy,⁴⁹ with the exception of the national multiple ownership rule. To the extent that Congress continues to embrace the goal of diversity, the current situation and how the policy changes of the 1990s created it are what matters now. Moreover, since Congress ordered the FCC in the Telecommunications Act of 1996 to periodically review its rules, the FCC could conclude that the rule changes it has implemented with agency discretion have harmed diversity, a goal that Congress continues to embrace. The FCC could re-institute those policies that successfully promoted source diversity in the past or it could seek new policies that will promote source diversity in the future.

⁴⁶ Cable Television Consumer Protection and Competition Act of 1992, Pub. L. No. 102-385, 106 Stat. 1460 (1992).

⁴⁷ Indeed, all of the major structural rules written in the late 1990s have been remanded by the court (broadcast multiple station limits, cable horizontal limits, newspaper cross ownership) or overridden by Congress (national cap).

⁴⁸ The 1996 Act provided for a biennial review (*Telecommunications Act of 1996*, Pub. L. No. 104-104, 110 Stat. 56 (1996)). This was later extended to four years (*FY2004 Consolidated Appropriations Act* (Public Law 108-109, 118 Stat. 3 et seq. Section 629) and the prohibited the FCC from further reviewing the national cap.

⁴⁹ As with the other rules overturned by the courts, in the case of the Fin-Syn rules, while the courts rejected the specific FCC rule (*Schurz Communications Inc. v. FCC* 982 F. 2^d 1043 (7th Cir. 1992)), it did not preclude the writing of an alternative rule. To date, the FCC has elected not to do so.

This paper shows that the current policies are not promoting independent production of video content on the major television platforms. Understanding the impact of past rule changes is the first step in the process of re-examining the decline of sources diversity on television. That is the subject of this paper. While the purpose of this paper is not to recommend specific policy changes, it is clear that if policymakers still believe in source diversity, then a change in policy that directly alters the structure and conduct of the vertically integrated oligopoly are is necessary.

OUTLINE

The paper is based on four sources of data:

- Over a dozen interviews with executives involved in the production of content for television, theatrical and video release.
- A review of the academic literature
- A review of the trade and popular press
- A database that charts market shares in every major domestic and foreign platform for exhibition and release of audiovisual product.

Chapter II outlines the basic issues and analytic approaches. It first describes the product space I am studying and then the analytic approach that I take.

Chapter III describes the policy changes and subsequent changes in market structure and conduct of the vertically integrated video entertainment product space. First it examines the impact of the repeal of the Fin-Syn rules on the market structure of the video entertainment product spaces. Then it surveys the current state of the video entertainment product space.

Chapter IV examines the change in the sources of content that resulted from the change in market structure. It begins with an analysis of prime time and broadcast programming. Then it turns to the patterns of distribution of TV movies, which includes a great deal of cable content. Finally it assesses the importance of prime time broadcasting to the overall video entertainment product sector.

Chapter V discusses the impact of the market structure on the production and distribution of content. The focus is on the gate-keeping role of the vertically integrated movie/broadcast/cable companies.

Chapter VI reviews that debate over the impact of the vertically integrated oligopoly on the quality of programming.

Chapter VII offers some concluding observations on the role of the Internet.

II. DEFINING THE PRODUCT SPACE AND ANALYTIC APPROACH

THE OBJECT OF STUDY

This is a study of the industrial organization of the video entertainment sector – theatrical movies, all forms of television and the sale and rental of tapes and DVDs – in the United States. Because the sector is complex, I adopt the following definitions. The sector consists of six primary channels for the distribution of content:

- **theatrical movie** releases,
- **prime time** airing of movies and series on broadcast television,
- **syndication** on broadcast television in non-prime time slots of both movies and series,
- movies and series aired on **pay cable**,
- movies and series aired on **basic cable** networks,
- **Home Video** – i.e. sale/rental of video for viewing on VCR and DVD players.

I refer to the overall sector made up of the six distribution channels as the **video entertainment product space**. The Internet has just begun to be used as a means of redistributing video product that was originally released through one of the other six outlets. While there are clear indications that it will change the current terrain of the video entertainment product space in the long run, there are also clear indications that it will not deconcentrate the sector. Already, the networks are multicasting current primetime programming through their websites and Internet protocol television (IPTV) channels are coming on line. Internet video on demand services (VOD), such as Cinema Now and Movielink, are gaining visibility and subscribers as broadband service penetrates deeper into

the consumer market, but the same content producers dominate. Broadcasters are poised to receive a substantial increase in their ability to distribute content with the transition to digital multicasting. The current single channel will be expanded by the granting of rights to use spectrum to broadcast up to six channels digitally. As such, there is growing concern that the same entities that dominate the traditional channels of physical distribution of video entertainment product will extend their dominance to the new Internet and digital distribution channels.

The nature and relationship between these channels has changed over time. Terms of art once applied have stuck, even though they may no longer technically describe the distribution channel.

Theatrical distribution of movies has been around the longest, with the commercial industry stretching back to the early part of the 20th century. Television emerged in the 1950s and 1960s. Cable arrived in the 1970s and 1980s. Distribution of video tapes began in the 1980s and exploded with the advent of DVDs in the early 2000s.

Traditionally, television was divided between broadcast and cable to reflect the different means of delivery. Broadcasters sent signals over the air from TV transmitters (stations) that were licensed by the FCC. Cable signals were sent from a head end through a wire, the laying of which was franchised by a local entity. Today, although broadcast signals are still available over-the-air, most American households (80% to 90%) get the broadcast product through the cable wire or from satellites.

Prime time on broadcast TV was always a focal point of policy because of the huge audience and resources it commanded. Prime time was controlled by the networks, which also held licenses to operate TV stations in the largest markets. They created national

networks by affiliating with independent license holders in markets where they did not hold broadcast licenses directly. The major networks – ABC, NBC and CBS, reach virtually every home in America. Fox is a national network as well, although it may be available in somewhat fewer homes.

Although cable has always been a subscription service, it split into two different distribution channels when pay cable services, like HBO, developed the ability to charge a premium for programming and basic cable became advertiser supported, mimicking broadcast television. Historically, one could draw a clear line between production of content by movie studios and exhibition – the presentation to the public of product – in theaters. The distinction breaks down with live television – the broadcast is simultaneously produced and distributed. Television also changes the nature of the exhibition from a public space to a private space, although it is still shared in the sense that programming is watched simultaneously, but separately, by large numbers of people. The sale/rental of videos (and the recording of programming) for home viewing (referred to as Home Video) extended the change from a public to a private experience by allowing people to choose when to watch.

ANALYTIC APPROACH: STRUCTURE, CONDUCT PERFORMANCE

The paper applies a framework of analysis known as the structure-conduct-performance paradigm (see Exhibit II-1),⁵⁰ which has been the dominant approach to industrial organization analysis for over three-quarters of a century. The premise is simple.

⁵⁰ Scherer, F. M. and David Ross, *Industrial Market Structure and Economic Performance* (Boston, Houghton Mifflin: 1990); Shepherd, William, G., *The Economics of Industrial Organization* (Prentice Hall, Engelwood Cliffs, N.J., 1985).

The analysis seeks to identify the conditions that determine the performance of markets.⁵¹ It starts with basic conditions.⁵² On the supply-side these include factors such as technology, product durability, business attitudes and the legal framework. On the demand side factors such as price elasticity, cyclical/seasonal patterns, and purchasing methods are included. These interact with characteristics of the market structure,⁵³ such as the number

⁵¹ Id., p. 4.

We seek to identify sets of attributes or variables that influence economic performance and to build theories detailing the nature of the links between these attributes and end performance. The broad descriptive model of these relationships used in most industrial organization studies was conceived by Edward S. Mason at Harvard during the 1930s and extended by numerous scholars.

Shepherd, William, G., *The Economics of Industrial Organization* (Prentice Hall, Engelwood Cliffs, N.J., 1985), p. 5, presents a similar view.

⁵² Scherer and Ross, p. 5.

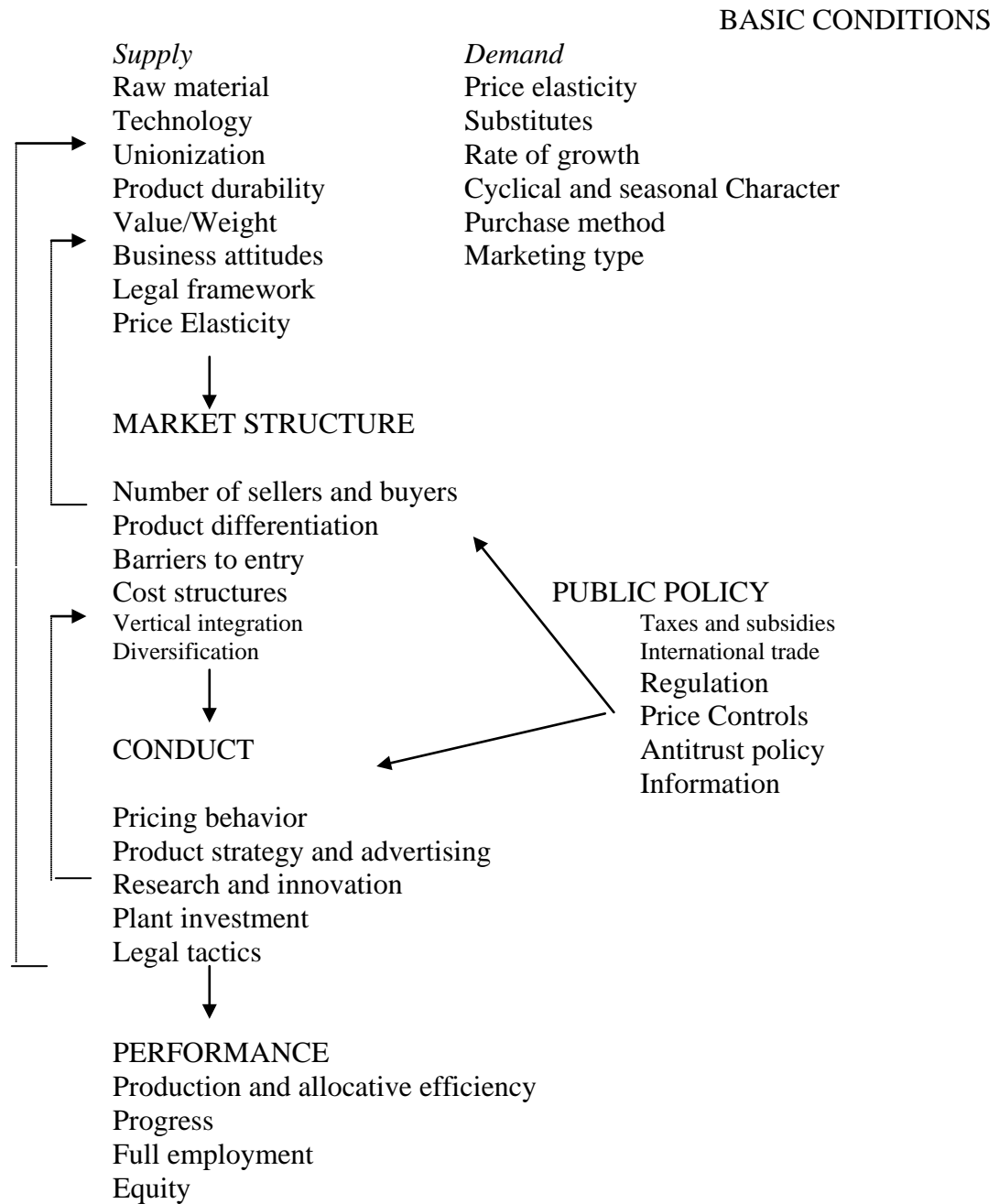
Market structure and conduct are also influenced by various basic conditions. For example, on the supply side, basic conditions include the location and ownership of essential raw materials; the characteristics of the available technology (e.g. batch versus continuous process productions or high versus low elasticity of input substitution); the degree of work force unionization; the durability of the product; the time pattern of production (e.g. whether goods are produced to order or delivered from inventory); the value/weight characteristics of the product and so on. A list of significant basic conditions on the demand side must include at least the price elasticity of demand at various prices; the availability of (and cross elasticity of demand for) substitute products; the rate of growth and variability over time of demand; the method employed by buyers in purchasing (e.g. acceptance of list prices as given versus solicitation of sealed bids versus haggling); and the marketing characteristics of the product sold (e.g. specialty versus convenience shopping method).

⁵³ Scherer and Ross, p. 5.

Conduct depends in turn upon the structure of the relevant market, embracing such features as the number and size distribution of buyers and sellers, the degree of physical or subjective differentiation prevailing among competing seller's products, the presence or absence of barriers to entry of new firms, the ratio of fixed to total costs in the short run for a typical firm, the degree to which firms are vertically integrated from raw material production to retail distribution and the amount of diversity or conglomerateness characterizing individual firms' product lines.

Exhibit II-1:

The Structure-Conduct-Performance Paradigm



SOURCE: Scherer and Ross, F. M., and David Ross, *Industrial Market Structure and Economic Performance* (Houghton Mifflin Company: Boston, 1990), p. 5.

and the size of sellers and buyers, product differentiation, cost structures and vertical integration (the relationship of production and distribution), to determine the conduct of the market participants. The key types of conduct include pricing behavior, product strategy and advertising, and legal tactics.⁵⁴ Conduct determines performance, traditionally measured in terms of pricing and profits, but increasingly viewed as quality and the nature and speed of innovation.

One of the key features of the structure-conduct-performance paradigm is that it recognizes the importance of public policy. Policies, such as antitrust enforcement, regulation, or taxation and subsidization, can directly affect structure and conduct, thereby altering performance.

HORIZONTAL MARKET POWER

The characteristic of market structures that received most public policy attention is horizontal market power. The concern is that if markets become concentrated – i.e. where a few players have a large market share – competition is dulled. Rather than compete to produce the best product at the lowest price, one large entity may be able to set prices up or otherwise affect output, without a sufficient response from others to discipline such behavior. With small numbers of competitors, they may accomplish the same thing by consciously paralleling each other's behavior. Thus, the Department of Justice defines market power as “the ability profitably to maintain prices above competitive levels for a significant period of

⁵⁴ Scherer and Ross, p. 4.

Performance in particular industries or markets is said to depend upon the conduct of sellers and buyers in such matters as pricing policies and practices, overt and taciturn interfirm cooperation, product line and advertising strategies, research and development commitments, investment in production facilities, legal tactics (e. g. enforcing patent rights), and so on.

time... Sellers with market power also may lessen competition on dimensions other than price, such as product quality, service or innovation.”⁵⁵

Pure and perfect competition is rare, but the competitive goal is important.⁵⁶

Therefore, public policy pays a great deal of attention to the relative competitiveness of markets as well as the conditions that make markets more competitive or workably competitive. Knowing exactly when a market is “too” concentrated is a complex question. The Department of Justice calculates an index called the Herfindahl-Hirschman Index (HHI) to categorize markets (see Exhibit II-2). This index takes the market share of each firm, squares it and sums it. It considers a market with an HHI above 1000 to be concentrated. This is the equivalent of a market with fewer than the equivalent of 10-equal sized firms. It considers a market with fewer than the equivalent of approximately 5.5-equal sized firms (HHI = 1800) to be highly concentrated. Markets with an HHI between 1000 and 1800 are considered moderately concentrated.

⁵⁵ Department of Justice/Federal Trade Commission, *Merger Guidelines* (1997).

⁵⁶ Scherer and Ross, p. 16-17.

In modern economic theory, a market is said to be competitive (or more precisely, purely competitive) when the number of firms selling a homogeneous commodity is so large, and each individual firm’s share of the market is so small, that no individual firm finds itself able to influence appreciably the commodity’s price by varying the quantity of output it sells... Homogeneity of the product and insignificant size of individual sellers and buyers relative to their market (that is, *atomistic* market structure) are sufficient conditions for the existence of pure competition, under which sellers possess no monopoly power. Several additional structural conditions are added to make competition in economic theory not only “pure” but “perfect.” The most important is the absence of barriers to entry of new firms, combined with mobility of resources employed.

**Exhibit II-2:
Describing Market Concentration for Purposes of Public Policy**

DEPARTMENT OF JUSTICE MERGER GUIDELINES	TYPE OF MARKET	EQUIVALENTS IN TERMS OF EQUAL SIZED FIRMS	HHI	4-FIRM SHARE (%)
	Monopoly	1 Firm with 65% or more	4250<	100
	Duopoly	2	5000<	100
		5	2000	80
HIGHLY CONCENTRATED	Tight Oligopoly		1800 OR MORE	
		6	1667	67
UNCONCENTRATED	Loose Oligopoly	10	1000	40
	Atomistic Competition	50	200	8

Sources: U.S. Department of Justice, *Horizontal Merger Guidelines*, revised April 8, 1997, for a discussion of the HHI thresholds; Shepherd, William, G., *The Economics of Industrial Organization* (Prentice Hall, Englewood Cliffs, N.J., 1985), for a discussion of 4 firm concentration ratios.

Many economists describe markets in terms of the market share of the top four firms.

Shepherd describes these thresholds in terms of four-firm concentration ratios as follows:⁵⁷

Tight Oligopoly: The leading four firms combined have 60-100 percent of the market; collusion among them is relatively easy.

Loose Oligopoly: The leading four firms, combined, have 40 percent or less of the market; collusion among them to fix prices is virtually impossible.

Although the overlap is not perfect, there is a close correspondence between these two approaches. A highly concentrated market is called a tight oligopoly.⁵⁸ A moderately concentrated market is called a loose oligopoly.

⁵⁷ Shepherd, p. 4.

MONOPSONY POWER

A second economic concept that plays an important part in the video entertainment product space is that of monopsony power. Monopsony power is the flip side of monopoly power. Monopoly power is the power of a seller to dictate prices, terms and conditions as a seller of goods and services to the public. Monopsony power is the power of downstream buyers of inputs to create products to sell to the public and to dictate the prices, terms and conditions on which they buy those inputs. If the upstream suppliers lack alternatives, they may be forced to accept terms that under compensate them or force them to bear extra risk. The downstream buyers have market power over the upstream sellers of the product. This can result in the production of fewer or inferior products for sale downstream.

Although monopsony has not been the focal point of much antitrust action, it is more likely in precisely the type of sector like the video entertainment product space, where inputs are specialized

Monopsony is thought to be more likely when there are buyers of specialized products or services. For example, a sports league may exercise monopsony (or oligopsony) power in purchasing the services of professional athletes. An owner of a chain of movie theaters, some of which are the sole theaters in small towns, may have monopsony power in the purchase or lease of movies. Cable TV franchises may exercise monopsony power in purchasing television channels that will be offered to their subscribers.⁵⁹

VERTICAL INTEGRATION AND LEVERAGE

A third key characteristic of many industries is the extent of vertical integration. In many industries the act of producing a product can be readily separated from its distribution and sale. Production is referred to as the upstream, distribution and sale are referred to as the

⁵⁸ Shepherd, p. 4.

⁵⁹ Sullivan and Grimes, p. 138.

downstream. Vertical integration occurs when both activities are conducted by one entity. Because vertical integration involves the elimination of a (presumably market-based) transaction between two entities it has been the focal point of a great deal of analysis. Economic efficiencies are frequently claimed for vertical integration due to the elimination of transaction costs. Others fear inefficiency and potential abuse of the ability to leverage vertical market power that can result from excessive or unjustified vertical integration.

The classic concern is that distributors of content, who are also producers, favor their own content at the expense of the content of unaffiliated producers. Vertical integration may become the norm in the industry, making it difficult for unintegrated producers to survive. Vertically integrated entities may capture the market for inputs, making it difficult for independent entities to obtain the factors of production necessary to produce product. Also, with vertically integrated entities dominating a sector, reciprocity and forbearance rather than competition may become the norm.

CONCLUSION

The remainder of this paper documents the emergence of a vertically integrated, tight oligopoly in the video entertainment product space. It shows that when public policies that prevented the exercise of market power were relaxed or eliminated, the conditions for the exercise of market power were quickly created by mergers and acquisitions and changes in behavior. The industry became a vertically integrated, tight oligopoly. Vertical leverage was used to eliminate independent production of prime time content. Monopsony power was exercised to squeeze independent film production into a very narrow, niche space on basic cable channels.

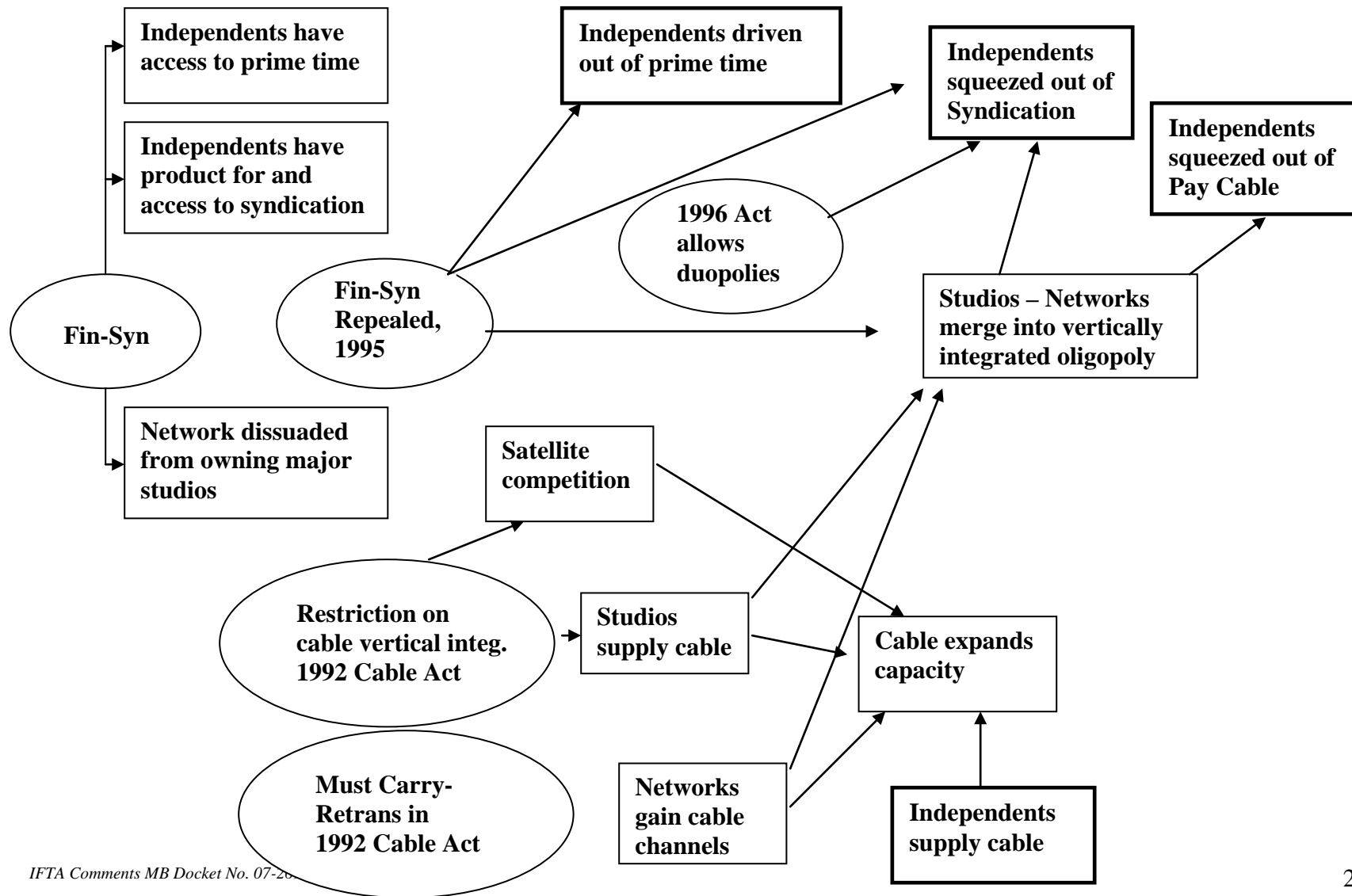
III. PUBLIC POLICY AND THE EMERGENCE OF A VERTICALLY INTEGRATED OLIGOPOLY IN VIDEO ENTERTAINMENT

THE REPEAL OF FINANCIAL AND SYNDICATION RULES TRIGGERS HORIZONTAL CONCENTRATION AND VERTICAL INTEGRATION

At the end of the 1980s, policies to disperse ownership in broadcast television were in place. Though they had been debated intensely throughout the 1980s, the policies remained to limit holders of broadcast licenses to one to a market. These stations were known as O&Os (owned and operated). Holders of broadcast licenses could have O & O stations that reached no more than 25% of the nation's television households. The national broadcast networks were restricted in the amount of content that aired in prime time they could own and their participation in the syndication of non-prime time programming (the Financial and Syndication Rule). The broadcast networks filled out their national networks by entering into affiliation agreements with stations they did not own or operate. There were extensive rules that governed the relationships between the affiliated stations and the networks.

Exhibit III-1 identifies the key policy changes (ovals) and the structural and conduct changes that followed (rectangles) in the 1990s. The primary policy that triggered the vertical integration in the industry was the decision of the FCC to allow the Financial and Syndication Rules to lapse, rather than write rules that would pass court scrutiny. (see Exhibit III-1). In retrospect, it is quite clear that

**Exhibit III-1:
The Impact of 1990s Policy Changes on Independents in the Television Market**



the Financial and Syndication rules, which restricted the amount of broadcaster-owned programming in prime time, had a major effect on the diversity of not only the broadcast television market, but television in general. When the rules were eliminated in the mid-1990s, broadcasters moved to replace the lion's share of independent programming with content they produced. Self-dealing became the predominant mode of operation.

Ironically, the impact was more profound than the direct effect on prime time. At the time that the Fin-Syn rules were relaxed, restrictions on vertical integration in the cable industry were implemented. Cable operators were restricted in the percentage of capacity on their systems they could fill with programming they owned. In the Cable Consumer Protection Act of 1992 they were also required to make their own programming available to competing delivery systems (the program access rules). As a result of the improved access to programming, satellite competition, which had been anticipated in the 1984 Cable Act, finally increased its market share. Satellite was a digital technology with greater capacity than cable. The cable industry responded by deploying its own digital capacity. Thus, just as the broadcast space was closing, the cable space opened for the majors and independents. The studios, which had been prevented from integrating with broadcasters, funded and supplied programming for cable channels. Given their structure, they could not provide nearly all the programming that a 24/7 channel required. A substantial market for independent movie production opened up.

Majors and independents were not the only beneficiaries of the 1992 Cable Act. The Act also gave the broadcasters a wedge into the cable platform, with the must carry/retransmission rules. Cable operators needed to carry the major broadcast networks to make their basic subscription packages attractive to the public. The Cable Act of 1992 gave the broadcasters

bargaining power over the cable operators. They could insist on a high fee for their national networks or they could negotiate for carriage of other programming. Must-carry and retransmission were government granted rights of carriage, means of ensuring access to audiences. The broadcasters chose to bargain for more channels on cable systems, rather than charge for their broadcast networks.

The 1996 Telecommunications Act reinforced this process. The Act allowed the FCC to lift the ban on horizontal concentration in the television industry. Broadcast licenses had been limited to one per entity in each market. The 1996 Act allowed the FCC to award more than one license per market after it had considered its impact on the industry. The FCC chose to allow duopolies in markets in which there would be at least eight “voices” in the market after the merger of two stations. Generally, the largest markets were opened to duopolies under the reasoning that diversity would be preserved in those markets.

For independents that sold product into TV syndication, this change had the opposite effect. By allowing the broadcast networks to own two stations in the most important markets – especially New York, Chicago and Los Angeles – a second major outlet was pulled into the tightening, vertically integrated core. The new owners of the second station now had a great deal of content of their own since, over the course of a decade, every major network acquired one of the major studios. Vertical integration became complete. Syndication was more difficult because access to the most important markets became much more difficult.

STRATEGIC MOVES

These changes did not take place instantaneously, but unfolded over a number of years for several reasons. When a policy change takes place, it frequently takes a period of time for

regulators to implement legislated requirements. Parties will frequently litigate such changes and move slowly until the legal terrain is clear. Further, existing business relations must unwind. Contracts run their course and new models are developed. Finally, because many of these policies are highly visible political decisions, market participants try to avoid triggering a political reaction with extreme moves.

The 1990s policy changes triggered a series of acquisitions and product developments over the course of the decade that created a vertically integrated oligopoly in the television industry (see Exhibit III-2).

**Exhibit III-2:
Major 1990s Acquisitions and Launches Involving Broadcasters in the
Creation of the Vertically Integrated Video Entertainment Oligopoly**

Year	Disney/ABC	Time Warner	Viacom/CBS	G.E.-NBC	Fox
1993		Turner acquires Castle Rock & New Line			Fox acquires NFL rights
1994			Viacom acquires Paramount		
1995		Time Warner launches WB	CBS launches UPN		
1996	Disney acquires ABC	Time Warner acquires Turner			
1999			CBS acquires King World Viacom acquires CBS	NBC acquires 30% of Paxson	
2001					Fox duopolies LA, Minn. DC Houston
2002				NBC acquires Telemundo NBC duopolies result	Fox duopolies Chic. Orl.
2003				GE Acquires Universal	

Source: Columbia Journalism Review, *Who Owns What*, August 22, 2006.

Most directly, the networks could monopolize access to audiences in prime time broadcast television, foreclosing the streams of revenue that sustain production of all forms of content. Within a decade, the amount of programming on prime time owned by the networks increased dramatically, from 15% to around 75%. First the independents were excluded from prime time, and then the major studios were absorbed.

Each of the big three networks merged with a major studio and acquired cable programming over the course of the 1990s. Fox had taken a different path to vertical integration. After being rebuffed in an effort to acquire Warner studio, News Corp. acquired Twentieth Century Fox and a number of television stations in major markets, both in 1985. Since the late 1970s, Twentieth Century Fox had been one of the least active of the major studios in providing television programming. Fox's focus through the 1990s would not be on original programming as traditionally defined for prime time. It would focus on sports in programming and broadcast duopolies.

Interestingly, Fox was vertically integrated but remained below the threshold for being subject to the Fin-Syn rules. For the big three networks who were subject to the rules, the repeal of Fin-Syn made mergers between networks and studios profitable, as self-supply was now allowed.

THE CURRENT STATE OF THE VIDEO PRODUCT ENTERTAINMENT SPACE

Vertical Integration

Within less than a decade after repeal of Fin-Syn and the passage of the 1996 Telecommunications Act, the process of vertical integration and horizontal consolidation was complete. This paper defines vertically integrated entities at the core of domestic video entertainment as the five firms that, in the past decade, have come to own major studios,

broadcast networks and cable TV channels while holding television station licenses as well (see Exhibit III-3). The names are familiar to all in both the television and the theatrical movie space. All of the entities have a presence in each of the major video entertainment areas – network television, cable television and movie production. These firms account for five of the seven studios that produce motion pictures – known as the majors.

The depiction and data in Exhibit III-3 are for the early 2000s. While there have been some changes in the direction of deintegration that movement is not complete and its implications are not yet clear. CBS and Viacom have become partially separated. They still share the same Chairman (Sumner Redstone). Each of the two potential entities is vertically integrated on its own, with distinct production and distribution facilities. Similarly, Fox and Liberty remain precariously intertwined by substantial ownership of shares, although an exchange and separation of ownership in Fox and DirecTV may be in the offing. These evolving situations may change the landscape somewhat, but the distribution arrangement made by the separate entities would still reflect the legacy of vertical integration. Thus, we may see these entities unwind toward truer deintegration and independence, although the history of Liberty teaches that spin-offs and pull-backs are entirely possible. Moreover, whether these developments will constitute a true opening of the field to independents, or whether these entities will simply substitute contractual relationships to duplicate the integrated flow of content, also remains to be seen. Nor is it clear that the parts that have been broken up will not use their remaining partially integrated assets (production and distribution) to reintegrate across

Exhibit III-3:
The Vertically Integrated, Video Entertainment Oligopoly

Parent	Television Property	Cable/Satellite	Film Production
News Corp.	35 TV Stations reach 39% of U.S. Households 9 duopolies – NY, LA, Chic. Minn. D.C. Dallas, Phoenix Orlando, Houston	Fox News, Fox Movie FX, FUEL, Nat. Geog. Speed, Fox Sports, Regional Sports, College, Soccer DirecTV	20 th Century Fox, Fox Searchlight, Fox Television S, Blue Sky Studios
General Electric	Fox Network 28 TV stations reaching 34% of U.S. households 6 duopolies through Telemundo – NY, LA, Chic., SF, Dallas, Miami NBC Network 30% of Paxson	CNBC, MSNBC, Bravo, Sci-Fi, Trio, USA	Universal
Disney	10 TV stations reaching 24% of U.S. households ABC Network	ESPN, ABC Family, Disney Channel, Toon Disney Soapnet, Lifetime A&E	Walt Disney Touchstone Hollywood Buena vista Pixar Miramax
CBS/Viacom	17 TV stations reaching 39% of U.S. households CBS Network CW King World	Showtime MTV, Nickelodeon BET, Mick at Night TV land, Noggin Spike TV, CMT Comedy Central, Flix The Movie Channel Sundance	Paramount Paramount Home
Time Warner	CW Network	HBO, CNN, Court TV, Road Runner New York News 1 Time Warner Cable 14.5 million subscribers	Warner Bros. Studios, TV Home Video Domestic Pay-TV Telepictures, Hanna- Barbera Witt-Thomas,

Source: Columbia Journalism Review, *Who Owns What*, August 22, 2006.

the entire space.⁶⁰ The effects of any real de-integration, if it comes about, will play out over time.

Note that each of the entities has a presence in all of the key areas of video production and distribution. Each owns studios that produce video product for both television and theatrical release. Each has substantial ownership of television distribution. The four national broadcast networks are represented here. The broadcasters have substantial ownership of TV stations. The fifth entity, Time Warner, is a major cable operator. As a result of the recent Adelphia acquisition and exchange of cable systems with Comcast, Time Warner dominates the two entertainment centers in the U.S., New York and Los Angeles. It also has a share in the new broadcast network, CW, to which its production operations are providing content.

Each of the five also has substantial cable offerings. Indeed 24 of the top 25 cable channels, as measured by homes passed, are owned by these five entities. In terms of actual viewers, as opposed to homes where programming is available, these five entities account for the vast majority – as much as 85 percent -- of prime time viewing.

Horizontal Concentration

Reflecting this concentration of subscribers, viewers and facilities, these five, vertically integrated entities have come to dominate the domestic U.S. video entertainment product space (see Exhibit III-4). They accounted for about three quarters to four-fifths of the output of the video product in terms of writing budgets, programming expenditures, hours of prime time content, and domestic theatrical box office or video sales/rentals.

⁶⁰ Grove, Martin A., "CBS' Moonves Smart to Eye Movies," *Hollywood Reporter.com*, July 7, 2006.
IFTA Comments MB Docket No. 07-269

Exhibit III-4: Vertically Integrated Video Oligopoly Domination of Television and Movie Production and Distribution (Circa 2001-2003)

<u>Revenue)</u>	<u>TELEVISION</u>							<u>MOVIES/DVD (U.S.</u>	
	Subscribers*		Writing Budgets		Programming Expenditures		Share of Prime Time	Box Office	Video
	#	%	\$	%	\$	%	%	%	%
	Million		Million		Million				
FOX/LIBERTY	1250	21	236	19	3803	9	3	11	10
TIME WARNER	925	15	206	17	7627	18	10	22	20
CBS/VIACOM	910	15	45	12	9555	22	28	8	7
ABC/DISNEY	705	12	132	11	6704	16	21	20	22
NBC/Universal**	<u>720</u>	<u>12</u>	<u>159</u>	<u>13</u>	<u>3879</u>	<u>9</u>	<u>21</u>	<u>12</u>	<u>15</u>
Subtotal	4315	75	772	72	31568	74	83	73	74
TOTAL	6000	100	1225	100	43212	100	100	100	100
HHI		1179		1084		1226	1775	1213	1258
FOUR FIRM CR		63		61		65	70	65	67

Notes and sources: * Subscribers includes broadcast and cable homes passed. ** Universal added to NBC to project post-merger market. Federal Communications Commission, In the Matter of Annual Assessment of the Status of Competition in Markets for the Delivery of Video Programming, CC Docket No. 00-132, Seventh Report, Tables D-1, D-2, D-3, D-6, D-7; Television Market Report: 2001 (Washington, D.C.: BIA Financial Network, 2001); Comments of the Writers Guild of America Regarding Harmful Vertical and Horizontal Integration in the Television Industry, Appendix A. Federal Communications Commission, In the Matter of Implementation of Section 11 of the Cable Television Consumer Protection and Competition Act of 1992; Implementation of Cable Act Reform Provisions of the Telecommunications Act of 1996 The Commission's Cable Horizontal and Vertical Ownership Limits and Attribution Rules Review of the Commission's Regulations Governing Attribution Of Broadcast and Cable/MDS Interests Review of the Commission's Regulations and Policies Affecting Investment In the Broadcast Industry, Reexamination of the Commission's Cross-Interest Policy, CS Docket No. 98-82, CS Docket No. 96-85, MM Docket No. 92-264, MM Docket No. 94-150, MM Docket No. 92-51, MM Docket No. 87-154, January 4, 2002; Bruce M. Owen and Michael G. Baumann, "Economic Study E, Concentration Among National Purchasers of Video Entertainment Programming," Comments of Fox Entertainment Group and Fox Television Stations, Inc., National Broadcasting Company, Inc. and Telemundo Group, Inc., and Viacom, In the Matter of 2002 Biennial Regulatory Review – Review of the Commission's Broadcast Ownership Rules and Other Rules Adopted Pursuant to Section 202 of the Telecommunications Act of 1996, Cross Ownership of Broadcast Stations and Newspapers, Rules and Policies Concerning Multiple Ownership of Radio Broadcast Stations in Local Markets, Definition of Radio Markets, MB Docket No. 02-277, MM Dockets 02-235, 01=317, 00-244, January 2, 2003; Federal Communications Commission, Program Diversity and the Program Selection Process on Broadcast Network Television, Mara Epstein, Media Ownership Working Group Study 5, September 2002, pp. 26; David Waterman, Hollywood's Road to Riches (Cambridge: Harvard University Press, 2005), pp. 21, 25.

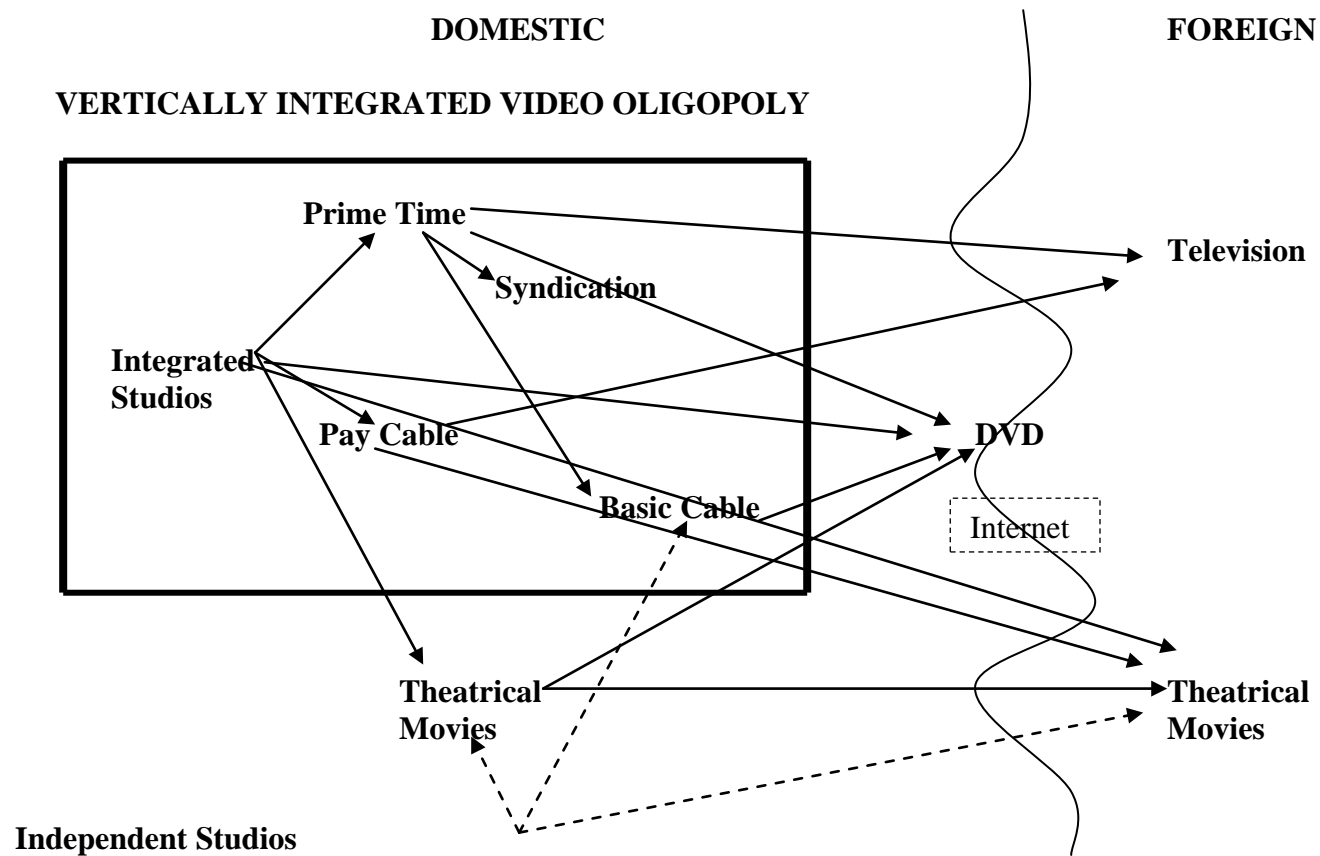
In each case, the HHI is in the concentrated range and the four firm concentration ratio is in the tight oligopoly range. The two potential changes in the sector noted above would not change this basic finding. Each of the measures of concentration would likely remain in the concentrated tight oligopoly range, but the identity of the leading firms might change a bit.

The broadcast space at the core of the vertically integrated oligopoly is extremely important to the overall market for video product (see Exhibit III-5). Where a program or film is placed in television space strongly affects not only its domestic revenues, but has a large impact on where it will be placed and what revenues it can earn in the international arena. By foreclosing the broadcast space, for both movies and series, the oligopoly core cripples independent producers and forces them into the cable arena, insofar as the independents desire to distribute over the television platform. The cable space, though, is a hostile environment as well, wherein the very same entities own the most attractive distribution channels in the space. Independents are forced into the least attractive cable channels on the least favorable terms.

THE CONDITIONS FOR THE EXERCISE OF MARKET POWER

Thus, the basic conditions for public policy concern about the potential exercise of market power are present. The empirical analysis demonstrates key economic characteristics of the video entertainment product space. It is a moderately to highly concentrated, tight oligopoly that is vertically integrated in production and distribution and exercises monopsony power – control and market power over the purchase of programming from independents.

**Exhibit III-5:
Location in the Domestic Exhibition Space Strongly Influences Prospects in Foreign Markets**



The remainder of this analysis presents evidence that market power has been exercised. In the process of creating the vertically integrated oligopoly, these entities behaved in a manner that created their market power through mergers, acquisitions and product development and exploited their market power through self-dealing, foreclosure of markets and imposition of onerous terms and conditions on suppliers. The key elements of the video entertainment product space include:

Market structure and market power

- Market shares that have risen to the level traditionally defined as a source of concern about concentration setting the stage for the abuse of market power.
- Substantial barriers to entry in the industry.
- A history of anticompetitive practices.

Vertical Integration

- Barriers to entry increased by vertical integration.
- The foreclosure of markets to unaffiliated producers through favoritism of affiliated upstream production and the subsequent exit of upstream, unaffiliated product suppliers from the market.
- Parallelism and reciprocity among the dominant firms in the oligopoly.
- A rush to integrate and concentrate across the sector.

Monopsony Power

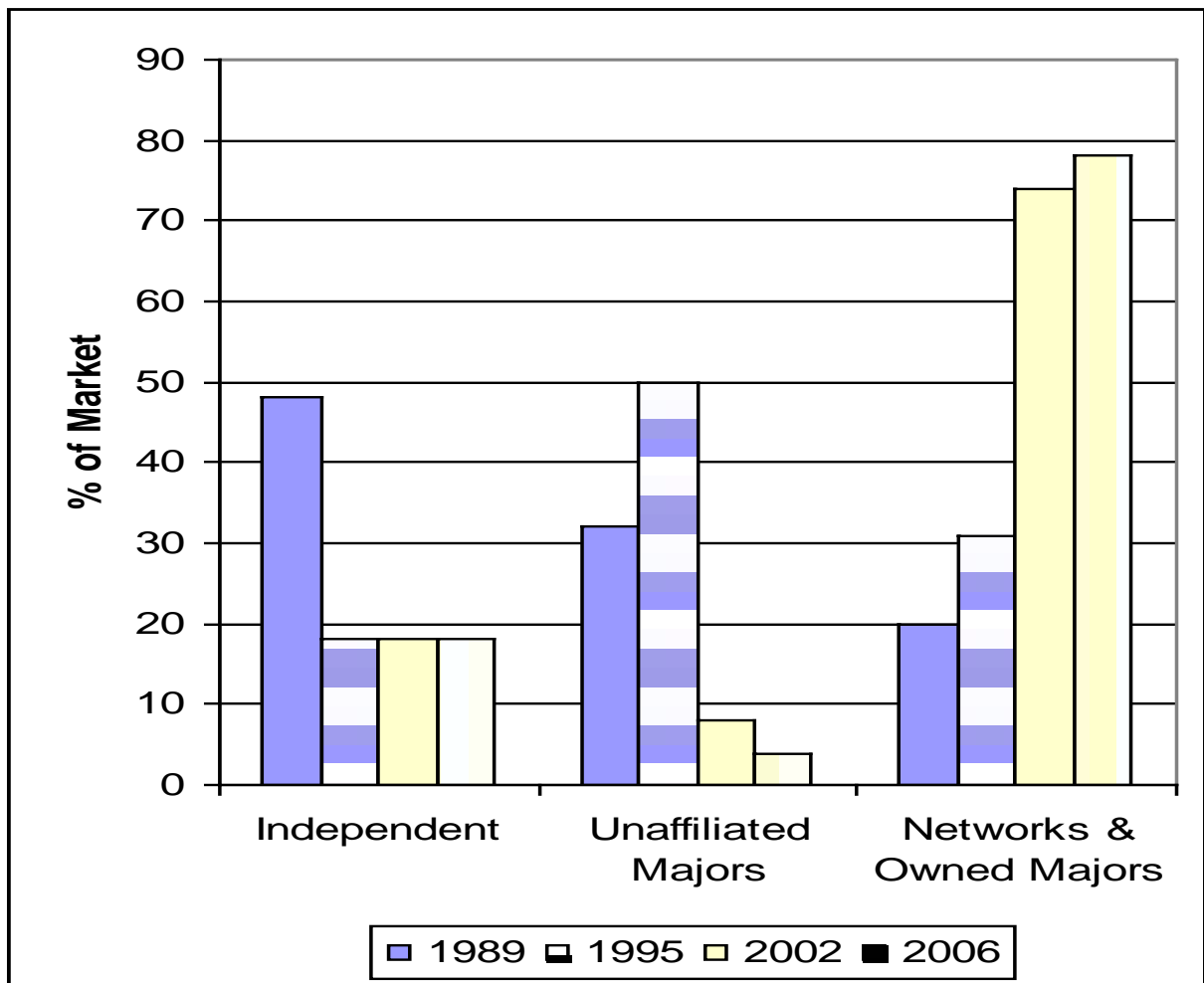
- The imposition of prices that squeeze unaffiliated producers and terms that shift risk onto those producers.
- Indications of a decline of quality in product attendant on the abuse of monopsony power.
- Flooding of downstream outlets with integrated product.

IV. DOMINATION OF THE TELEVISION PRODUCT SPACE

PRIME TIME ON BROADCAST/NETWORK TELEVISION

The central empirical fact at the core of the narrative of the 1990s is the dramatic and swift change in the ownership of prime time programming after the repeal of the Fin-Syn rules (see Exhibit IV-1). Studies of prime time programming just prior to the repeal of the

**Exhibit IV-1:
Prime Time Market Shares**



Source: 1989-2002 calculated from Mara Einstein, *Media Diversity: Economics, Ownership and the FCC* (Mahwah: Lawrence Erlbaum, 2004), p. 169; 2006 based on Baseline Research, *Fall Television Schedule: 2006-2007 Season*.

Fin-Syn rules find that the networks owned around 15 percent of shows aired in prime time. Major studios owned about one-third and independents accounted for about a half. Within five years, the role of the independents had been dramatically reduced – to less than one-fifth of the programming. Networks had grown to almost 40 percent. The major studios still accounted for around 40 percent. The mergers of the networks and studios followed and the vertically integrated entities came to dominate prime time, accounting for over three quarters of the programs. In 1989, fifteen entities produced 2 percent or more of the programming on prime time. By 2002, that number had shrunk to five. The programming produced by independents in 2006 was largely reality shows, not scripted programming, as had been the case in the recent past.

Traditional measures of market concentration used in economic analysis reinforce this observation. As Exhibit IV-2 shows, the prime time market moved very quickly from an unconcentrated competitive market (CR4=34%; HHI=541) to a tight oligopoly (CR4=74%) well up into the moderately concentrated range (HHI=1596). If the calculations are based only on series, i.e. excluding movies, the concentration is even greater. Within a decade after

**Exhibit IV-2:
Concentration of Prime Time Programming**

Year	Four Firm Concentration	HHI	Four Firm Concentration	HHI
<i>All Prime Time Hours</i>			<i>Series only</i>	
1989	35	541	40	703
1995	47	776	57	1165
2002	74	1596	84	2070

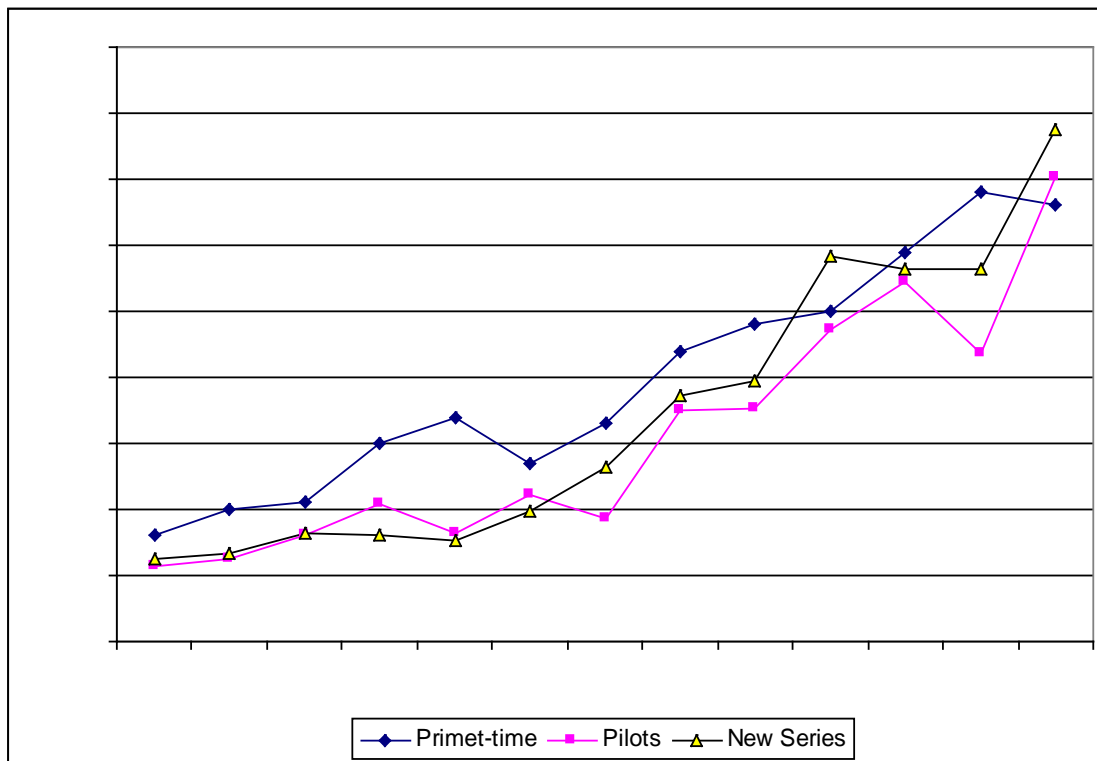
Source: Calculated from Mara Einstein, *Media Diversity: Economics, Ownership and the FCC* (Mahwah: Lawrence Erlbaum, 2004), p. 169.

the repeal of Fin-Syn, the market was a highly concentrated (HHI=2070) tight oligopoly (CR4=84).

NEW SHOWS AND PILOTS

Exhibit IV-3 shows the pattern of ownership by the networks of prime time programming, new shows and pilots. We observe a modest increase in network ownership in the early 1990s, as the Fin-Syn rules were partially repealed, debated and litigated. With final repeal of the rules in 1995, we see a rapid and steady increase in network ownership.

**Exhibit IV-3:
Network Ownership of Prime-Time Programming 1990-2002**



Source: Calculated from Mara Einstein, *Media Diversity: Economics, Ownership and the FCC* (Mahwah: Lawrence Erlbaum, 2004), p. 171; William T. Bielby and Denise D. Bielby, "Controlling Prime Time: Organizational Concentration and Network Television Programming Strategies," *Journal of Broadcasting & Electronic Media*, 47: 4 (2003), p. 588.

The pattern has persisted, as an analysis of the 2006-2007 season shows (see Exhibit IV-4). The networks get over half of their programming internally. The four major networks also buy programming from one another. Overall, independents account for less than one-fifth of prime time programming. On the four major networks, the independents account for about one-seventh. The independent programming is generally reality shows, not scripted programming.

**Exhibit IV-4:
Primetime 2006-2007 Programming
(Percent of Hours)**

	Self-Dealing	Internal Big-5 Dealing	Sony	Independents
ABC-Touchstone	52	20	3	25
CBS-Paramount	57	38	0	5
NBC-Universal	67	14	5	14
FOX-20th Century	52	29	6	13
CW-Warner/ Viacom	53	0	7	40
Total	57	21	4	18

Source: Baseline Research, *Fall Television Schedule: 2006-2007 Season*

SYNDICATION

Syndication has been studied less than prime time, but the available data suggests a similar pattern (see Exhibit IV-5). Although there is less self-dealing, the five networks dominate the syndication market because of a large amount of internal dealing.

Particularly interesting to note is the lack of recent independent shows in syndication.

Having been forced out of prime time, independents simply do not have series to place as product in syndication.

**Exhibit IV-5:
Self-Dealing and Internal Dealing in First-Run Syndicated Programming (2004)**

TYPE OF TRANSACTION	HOURS	
	All Shows	Shows Less Than 2 Years Old
Self-Dealing (Subsidiaries of Big 5 syndicating to themselves)	32%	61%
Internal Dealing (Subsidiaries of Big 5 syndicating to Big 3 station groups)	41	16
Independents syndicating to Big 3 Station Groups	18	0

Sources and Notes: Calculated from Goro Oba and Sylvia M. Chan-Olmstead, "Self-Dealing or Market Transaction?: An Exploratory Study of Vertical Integration in the U.S. Television Syndication Market," *Journal of Media Economics*, 19 (2), 2006, p. 113.
Big 3 station groups are CBS/Viacom, Fox and ABC
Big 5 syndicators are King World, Paramount, 20th Century Fox, Buena Vista, WB and Universal. Other Major is Sony (Columbia). Independents are "other."
There are 22.5 hours per week of first-run syndicated programming in the 9am to 8pm day part analyzed (77 hours).

The foreclosure of the broadcast/network television market, particularly for 1st run series, is reinforced by a complete lack of pilots coming from independents. Interviews with independent producers done for this paper reveal that since there is little chance that they will get on the air, they have abandoned this market.

I have noted that the decision to allow broadcasters to hold multiple licenses in a single market contributed to the difficulties of independents gaining access to the syndication market. The network owners would use their internally produced content on the television stations in the largest markets, squeezing the space available to unaffiliated producers. About 75 duopolies were created soon after the ban on holding multiple

licenses was lifted. The national networks concentrated their duopoly acquisitions in the top ten markets, even though owning multiple stations within a market did not count against the national cap on how many homes they were allowed to reach. These markets account for about 30 percent of all the TV households in the country and almost 40% of all the TV revenues in the country. The big four network's market share in the top three markets was particularly high. These three markets alone account for about 15 percent of the population and almost 20 percent of TV revenues in the nation.

Exhibit VI-6:

Big 4 Network Duopolies and Market Share in Top 10 Markets

<i>Designated Market Area</i>	<i>Number of Big 4 Duopolies</i>	<i>Market Share Big 4 Duopolies</i>	<i>Total Market Share of Big 4</i>
New York	2	44	77
Los Angeles	3	62	79
Chicago	2	40	73
Philadelphia	1	25	57
San Francisco	2	37	56
Boston	1	28	42
Dallas	3	59	59
Washington D.C.	1	27	52
Atlanta	0	0	24
Detroit	1	24	42

Source: BIA Financial, *Television Market Report*, 2003

TV MOVIES, THE ROLE OF CABLE

The history of prime time programming is primarily a story about television series. While a small number of made for TV movies appear in prime time, the overwhelming majority of programming is series. Interestingly, for independents, the growth of cable in the late 1990s was a story about TV movies.

To analyze the changing patterns of TV movies, I examined all films aired in three four-year periods (see Exhibit IV-7. The first period was before the Fin-Syn rules were in play (1985-1988). The second period was the four years after Fin-Syn was repealed (1995- 1998). The third period was after the networks became integrated with studios (2001-2004).

**Exhibit IV-7:
TV Movies Across All Distribution Channels**

<u>Cable</u>	Percent of Movies		
	<u>Broadcast</u>	<u>Basic Cable</u>	<u>Premium</u>
1985-1988 (n=47)			
Independent	39	0	2
Network	47	2	2
Majors	9	0	0
1995-1998 (n=206)			
Independent	33	13	16
Network	18	1	5
Majors	11	0	2
2001-2004 (n=634)			
Independent	7	41	9
Network	5	20	7
Majors	5	5	1

Source: Baseline Beta Studio System Database.

I relied on the baseline database and included only movies that were aired and for which a network and at least one producer was identified. Where a network was listed as a producer, the movie was considered to be produced by the network, even if other (unaffiliated) producers were identified. This is the critical assumption in the sense that I am assuming, implicitly, that the movie would not have been aired on the network, but for the network's interest in the co-production. Of lesser importance is the assumption that where a network and its major movie studio are both listed as producers, the studio

was considered to be the producer. While these distinctions could be interpreted in other ways, the basic patterns in the data would not change much. The key findings about independent producers are quite clear (as shown in Exhibit IV-7).

The pattern of broadcast movies follows the pattern we observed for series. The independents played a large role under Fin-Syn, were diminished immediately after the repeal of Fin-Syn and then reduced dramatically within a decade. Their share in premium movies grew in the mid-1990s, but was reduced after the integration of the studios.

In the most recent period, cable movies have become quite prominent. The numbers of movies produced have increased dramatically. In the mid-1990s, independents aired about 120 movies, 95 of them on broadcast and premium cable. In the 2001-2004 period, they produced over 100 movies on broadcast and premium cable, and over 260 on basic cable. The apparent increase in production, however, is less significant than it appears. There are two different sets of reasons that the expansion has not helped independents greatly. One set has to do with the nature of the business and the distribution channels.

First, broadcast and premium movies have much higher budgets and larger audiences. Thus, the 100 movies produced by independents that aired on broadcast and premium cable probably had a substantially larger total budget and a larger audience than the 260 movies that aired on basic cable.

Second, where studios compete for resources to maintain a production base, the relative output is important. Whereas the independents grew by about 6 percent between the mid 1990s and the early 2000s in the high value spaces, the networks and major

studios grew by almost 60 percent. As the networks grew larger and larger, they control more resources in the sector.

Third, placement on basic cable makes it more difficult to tap into other revenue streams – DVD sales/rentals and foreign television – which have become vital to maintaining the program’s prominence.

The second set of factors that suggest the growth of basic cable as an outlet is less important than it appears has to do with the market structure.

First, approximately 80 percent of the basic cable movies aired in the 2001-2004 period on networks is now owned by two of the vertically integrated media corporations – ABC/Disney (ABC family, Disney Channel and Lifetime) and NBC (Sci-Fi).

Second, the genres are highly specialized. These cable networks buy three genres, each with a respective dominant buyer. ABC Family/the Disney Channel buy family/children-oriented movies. Lifetime buys romances. Sci-fi buys science fiction films. This is a classic situation for the exercise of monopsony power.

Third, the vertically integrated oligopoly that dominates the other video outlet spaces also thoroughly dominates the TV movie space. The five entities I have identified as the vertically integrated oligopoly account for about three-quarters of the distribution of movies: one-third through broadcast and premium cable, a little over one-third through basic cable, and another handful on general networks (A&E, MTV, ESPN, FX, Spike).

ACCESS TO TELEVISION IS CRUCIAL TO THE HEALTH OF INDEPENDENT PRODUCERS

Thus, I have shown that the independents were largely eliminated from prime time broadcasting and relegated to basic cable movies. This places the independents at a

severe disadvantage because television and the broadcast space at the core of the vertically integrated oligopoly remain extremely important to the overall market for video product. Exhibit IV-8

presents order of magnitude estimates of the revenues, expenditures and audiences for domestic movie producers and the domestic TV sector. It contrasts cable and broadcast revenues with to sources of revenue for movie producers that are ‘independent’ of the domestic TV sector – domestic and foreign theatrical releases and home video sales.

**Exhibit IV-8:
The Importance of Television in the Video Entertainment Product Space
(circa 2003-2004)**

MOVIES			TELEVISION	
	Majors	Independents	Broadcast	
Cable/				
Satellite				
Revenues (Billions)				
Domestic			Ad Revenue/	\$35
\$50				
Box Office	\$ 8.0	\$1.0	Subscription	
Home Video	<u>11.0</u>	<u>1.3</u>		
Subtotal	19.0	2.3		
Foreign				
Box Office	8.0	1.0		
Home Video	<u>8.0</u>	<u>.8</u>		
Subtotal	16.0	1.8		
Total		38.3		85
Programming	7.0	.4		\$40
Budgets (Billions)				
Audience (Hours Per Year)				
Theatrical		13	Broadcast	780
Home Video		80	Basic	
830				
Total		93	Premium	
180				

Sources: U.S. Box Office and Programming budgets are based on MPAA, *Theatrical Market Statistical Report, 2005*. Programming budgets do not include marketing and assume 120 releases from the majors. Foreign Box Office, home video and TV revenues are from David Waterman, *Hollywood's Road to Riches* (Cambridge: Harvard University Press, 2005), Table C.1. Independent programming budgets from American Film Marketing Association, *The Economic Impact of Independent Film Production*, April 2003. Cable Revenue is from Federal Communications Commission, *Twelfth Annual Report in the Matter of Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming*, MB Docket No. 05-255, March 3, 2006, p. 19.

The revenue from the TV sector is much larger than the domestic revenue sources for the movie industry – about four times as large – even when video sales/rentals are included. Total revenues from these sources are over two times as large. Even if we were to factor in the domestic and foreign TV revenues of movie producers, the domestic TV sector would be almost twice as large.⁶¹

Programming expenditures of the domestic TV sector are on the order of five to six times as large.

The extreme importance of TV in terms of audience is also clear. Broadcast and cable pull almost twenty times the audience of movies, even combining theatrical and home video viewing. Premium cable (arguably similar to movies since it is a pay service) alone has a larger audience.

Although basic cable and broadcast are about equal in audience, prime time broadcast is still the dominant exhibition space on TV. For example, the advance sales of advertising slots on the four national networks – called the up front sales – equals the total annual Box Office of theatrical releases in the U.S. Advertisers pay a rich premium for this space because the networks still aggregate many more viewers than cable shows. As Mara Einstein, the author of the most comprehensive analysis of the repeal of the Fin-Syn rules noted, the gatekeeper role of the networks is essential since,

⁶¹ The sources cited in Exhibit IV-8 put this revenue at about \$8 billion.

while the networks must decide between best show versus best buy, they remain acutely aware of their ability to provide something that no other media vehicle can, and that is the ability to create a valuable asset because no medium can provide the kind of exposure and promotion that network television does.⁶²

The networks are well aware of their advantage. As Les Moonves recently put it, “If you want 30 million people, you can’t get that anywhere else.”⁶³ The next chapter examines how that gatekeeper role impacted access to distribution under the new policies adopted in the 1990s.

⁶² Einstein, Mara, *Media Diversity: Economics, Ownership and the FCC* (Mahwah: Lawrence Erlbaum, 2004), p. 192.

⁶³ Fabricant, Geraldine and Bill Carter, “A Tortoise Savors the Lead,” *New York Times*, September 12, 2006, p. CC11.

V. THE IMPACT OF MARKET STRUCTURE ON INDEPENDENT PRODUCTION

THE CRITICAL ROLE OF GATE KEEPING IN THE VIDEO PRODUCT SPACE

At the center of the picture I have painted of vertical integration following the policy decisions of the 1990s stand the broadcasters as gatekeepers of access to audiences. A key role in the process was played by the absorption of the major studios. Interestingly, David Waterman's recent economic history of the major studios is based on the premise that

the most important feature of the studios is their role as *distributors*, and we often refer to them by that term. By controlling distribution, the studios act as gatekeepers: they decide which movies get produced and how they are made, and they also largely determine when and at what price viewers get to see them on which media.⁶⁴

The key gate keeping role of distribution in the video entertainment product space was integrated and consolidated with production in single entities in the first 50 years of the movie industry. While there is a debate about the factors that shaped the role of the major studios, Waterman pinpoints two critical issues that parallel the core of my analysis of the video product space in the 1990s. One was a policy decision that forced deintegration.

Fox, MGM, Warner, Paramount, and RKO, known at the time as the five majors, were vertically integrated into production and theater exhibition and had consistently dominated the industry since the mid-1930s. The three others – Universal, Columbia and United Artists, known as “the minors” at the time – owned no theaters... All eight of these studios were brought to trial by the U.S. Justice Department in the 1940s, and an eventual Supreme Court decision in 1948, *United States v. Paramount Pictures, Inc. et al.*, ruled that the eight distributors had violated the Sherman Act and other antitrust laws... The Court ordered the five major distributors to divest their extensive theater holdings... established a

⁶⁴ Waterman, David, *Hollywood's Road to Riches* (Cambridge: Harvard University Press, 2005), p. 16.

number of regulations on contractual relationships between distributors and theaters that were incented to level the playing field for independent companies.⁶⁵

The second factor that shaped the market for theatrical movies was the growth of television.

After the *Paramount* decision, the prewar stability of industry structure among the eight Paramount defendants began to crumble. Industry positions of the majors and the minors converged, and the extent of independent entry increased. We argue in the following chapter that the almost coincident diffusion of television has more profound long-range effects on the movie industry than did *Paramount*, but it is likely that ascendance of all three of the minor studios into the majors ranks, and perhaps the rise of independents in the 1960s, were related to the Court's intervention.⁶⁶

Thus, the policy of forcing deintegration of production and distribution of theatrically released movies opened the door to entry, while the advent of television created a whole new channel for the distribution of video product. Waterman reckons that the technological factor played a large part in shaping the video entertainment space, although not so much in determining concentration as in altering the types of products the sector produced and the marketing patterns of those products. However, from the point of view of the analysis in this paper, the critical point is that the convergence of the same two factors – integration policy and multiple distribution platforms – that worked to weaken the gatekeeper role of the studios in the 1950s, worked in the opposite direction for the broadcasters in the 1990s. Removing the policy restriction on vertical integration opened the door to reintegration of the production and distribution of video product and the merger of production (studios) and distribution (broadcasting and cable). The lesson

⁶⁵ Waterman, p. 30.

⁶⁶ Waterman, p. 23.

is clear: if given the chance, entities will merge and integrate vertically in order to dominate the sector by controlling distribution.

Mara Einstein, already described above as conducting the most thorough investigation of the Financial Interest and Syndication rules, notes that before and after the policy limiting vertical integration the broadcasters used their control over access to audiences to monopolize ownership of network programming.

Before the Fin-Syn rules were in place, networks asserted ownership over prime-time programming.

In the 1970s, what led the FCC to institute the financial interest and syndication rules was a concern that the networks were becoming both too powerful and too demanding when it came to the [program] selection process. Too powerful in that they were the gatekeepers of news, information, and entertainment for the American public. This was so because of the limits of radio spectrum... Too demanding, because networks were requiring an equity stake in a program before it would be accepted as part of the prime-time schedule.... [T]he networks had ownership of more than 70% of their prime-time schedule by the mid-1960s, up from only 45% the previous decade. The strong arming of producers was a fundamental reason for the creation of fin-syn.⁶⁷

The timing is informative. TV arrives on the scene in the 1950s and becomes the dominant medium by the early 1960s. In the early days, broadcasters lacked both production capacity and market power to self-supply content. Once television achieved ascendance, the broadcasters used their resources and leverage to assert ownership over prime time programming.

The broadcast networks also had a history of antitrust problems in their role as gatekeepers of access to the television audience. In 1978 they lost an antitrust case that paralleled the *Paramount* case.

⁶⁷ Einstein, Mara, *Media Diversity: Economics, Ownership and the FCC* (Mahwah: Lawrence Earlbaum, 2004), p. 179

In the *Unites States v. National Broadcasting Co.*, The government specifically accused the National Broadcasting Company (NBC) of restraint of trade as it related to purchasing programs from independent producers and of using its network power to monopolize prime-time programming production of shows broadcast on the network. The Department also claimed that NBC, with CBS and ABC, was trying to develop a monopoly over the television programming market.⁶⁸

After a twenty-year period in which the networks were restrained by the Fin-Syn rules, the broadcasters moved to reassert ownership in prime-time programming once the rules were repealed.

Since the rules were repealed in 1995, the economic structure of the industry changed drastically. The television networks have become vertically integrated institutions with the ability to produce programming through internal business units. Corporate parents put pressure on the networks to purchase programming internally to achieve synergies and, of course, increase profits. Being part of large media conglomerates, there is added pressure on the networks to be profitable so that Wall Street may find the parent company appealing.⁶⁹

The networks each have at least a 50% stake in the programming on their air and some have as high as 70% and even 90%.⁷⁰ The networks could never achieve those kinds of ownership numbers without requesting a stake in the programming that appears on their air. It is no secret to anyone that the networks do this.⁷¹

In the previous section I have noted the evolving pattern of behavior by the broadcasters in asserting ownership of prime time programming. Bielby and Bielby have argued that network behavior was political, as well as economic, and noted the evolving nature of their rhetoric. At first the broadcasters argued that the independents would not be squeezed out. Later they argued that independents were irrelevant.

The network executives' initial position was that independent producers would thrive in a deregulated industry and that network ownership was not a threat to creativity and program quality. Increasingly, in recent years, network executives and deregulation advocates have taken the position

⁶⁸ Einstein, p. 60.

⁶⁹ Einstein, pp. 179-180.

⁷⁰ Einstein, p. 217, citing Mermigas, 2002,

⁷¹ Einstein, p. 217.

that their opponents' positions are irrelevant, because they are out of touch with the realities of the marketplace. In effect, they are saying, vertical and horizontal integration were necessary for the industry to survive in the face of rising costs and increased competition from new technologies.⁷²

As this process unfolded, the impact was felt in more than just access to audiences. The leverage that the vertically integrated core of the industry acquired also dramatically changed the terms of trade between the independents and vertically integrated conglomerates. With a small number of vertically integrated buyers and a large number of much smaller product sellers, the core oligopoly gains monopsony power. They can impose onerous terms on the supplier, appropriating maximum surplus. With all of the major distribution channels under their control, the vertically integrated oligopoly can slash the amount they are willing to pay for independent product.

MARKET STRUCTURAL IMPACTS OF HORIZONTAL CONCENTRATION AND VERTICAL INTEGRATION

The pattern of behavior and structural changes in the industry should raise red flags for public policy. One major concern about vertical mergers is that the industry undergoes a rush to integration and consolidation. Being a small independent firm at any stage renders a company extremely vulnerable to a variety of attacks.

Oligopolies often settle down into behavioral patterns in which price competition atrophies, even though some or all sellers suffer from excess capacity. Non-price rivalry then becomes crucial to the distribution of sales. One form of nonprice competition is the acquisition of downstream enterprises, which all else (such as prices) being equal will be purchased from their upstream affiliates. If acquisition of this sort deflects significant amounts of sales, disadvantaged rivals are apt to acquire other potential customers in self-defense, and reciprocal fear of foreclosure

⁷² Bielby William T. and Denise D. Bielby, "Controlling Prime Time: Organizational Concentration and Network Television Programming Strategies," *Journal of Broadcasting & Electronic Media*, 47: 4 (2003), p. 585.

precipitates a bandwagon effect in which the remaining independent downstream enterprises are feverishly sought.⁷³

If there are 10 nonintegrated firms and only one of them integrates, then little affect on competition might occur. But if this action induces the other 9 to do the same, the ultimate impact of the first “triggering” move may be large. Any increase in market power is magnified.⁷⁴

A second, related concern about vertical integration that arises from the observed behaviors is that it can create or reinforce barriers to entry into the industry. By integrating across stages of production, incumbents may force potential competitors to enter at both stages, making competition much less likely. “[V]ertical mergers may enhance barriers to entry into the primary industry if entrants must operate at both stages in order to be competitive with existing firms and if entry at both stages is substantially more difficult than entry at one stage”.⁷⁵

Capital market hurdles are only one of the barriers to entry that vertical integration and conglomeration can create. Such mergers can also foreclose input markets to competitors.

When all production at a level of an industry is “in-house,” no market at all exists from which independent firms can buy inputs. If they face impediments or delays in setting up a new supplier, competition at their level will be reduced. The clearest form of this is the rise in capital a new entrant needs to set up at both levels.⁷⁶

The experience in the video product space over the two decades in which the vertically integrated oligopoly emerged suggests that vertical integration increased barriers to entry into the television sector.

[B]ecause the vertically integrated structure creates such a barrier to entry... it is not necessary for these executives to collude.... The

⁷³ Scherer and Ross, pp. 526-527.

⁷⁴ Shepherd, p. 290.

⁷⁵ Perry, p. 247.

⁷⁶ Shepherd, pp. 289-290.

complexity has made it almost impossible for new players to enter the market, because they have to do so on so many levels – production, distribution, cable outlets, and so forth.⁷⁷

Compared to recorded music, production costs in television are astronomical, creating substantial barriers to entry to new program suppliers and creating incentives to the networks to demand greater control over costs.... In the increasingly deregulated business environment, the enhanced market power of the corporations that control access to channels of distribution has made it more difficult for independent suppliers of new television series to survive in the industry. Moreover, the high cost of producing episodic television makes it extremely difficult to operate through channels of distribution outside of network television, such as first run syndication or cable (especially when those off-network venues are increasingly controlled by the same corporations).⁷⁸

FAVORING AFFILIATES

The gatekeeper role translates into leverage because “with increased vertical integration, independent producers have less access to audiences, or they must align themselves with studios or networks to get their shows on the air.”⁷⁹ Einstein concludes that integration favors internally produced product.

Given vertical integration and the combined network/programming departments, all things being equal, an internally produced show is going to get an airing over one in which the network does not have an interest. It is also more likely to get a better time slot and be kept on the air longer. While it is possible that some shows of lesser quality are given preference over those produced by outsiders, this is a situation that is not likely to be sustained.⁸⁰

Producers claim that with the demise of the Fin-Syn Rules, networks have used their enhanced market position in several ways to gain unfair advantage over outside program suppliers. First, they claim that when selecting series for the prime-time schedule and deciding between a series from an outside producer versus one of comparable or even less quality

⁷⁷ Einstein, p. 217.

⁷⁸ Bielby and Bielby, p. 341.

⁷⁹ Einstein, pp. 180-181.

⁸⁰ Einstein, p. 194-195.

produced in-house by the network or by a network joint venture, the network will favor the series in which it has a financial interest. Moreover, many producers perceive that this kind of favoritism has intensified in recent years.⁸¹

Exclusive and preferential deals for the use of facilities and products compound the problem.

The first firms to integrate into neighboring stages reduce the number of alternative sources for other firms at either stage. This “thinning” of the market can increase the costs of market or contractual exchange. Subsequent integration by other firms then becomes more likely.⁸²

Concerns arise that not only will the dominant firm in the industry gain the leverage to profitably engage in anti-competitive conduct, but also the dynamic processes in the industry will clearly shift toward cooperation and coordination rather than competition. The issue is not simply collusion, although that is clearly a concern.

The *Guidelines* do recognize three major competitive problems of vertical mergers in concentrated industries. First, forward mergers into retailing may facilitate collusion at the manufacturing stage by making it easier to monitor prices or by eliminating a “disruptive buyer.”⁸³

Beyond collusion, a mutual forbearance and reciprocity occurs as spheres of influence are recognized and honored between and among the small number of interrelated entities in the industry.

Now we consider the big picture, rather than market-by-market effects. Imagine an extreme situation, with five big diversified firms extending into all major sectors. They coexist in parallel, touching one another in hundreds of markets. Whatever their effects on each market might be, they pose a larger problem of spheres of interest, or diplomatic behavior replacing competition ...

⁸¹ Bielby and Bielby, p. 581.

⁸² Perry, Martin, “Vertical Integration: Determinants and Effects,” in Richard Schmalensee and Robert D. Willig (Eds.) *Handbook of Industrial Organization* (New York: North-Holland, 1989), p. 247.

⁸³ Perry, p. 247.

Reciprocity is an exchange of favors. Reciprocal buying is one form of it. At its simplest, firm A buys from firm B because of some purchase that B makes from A ...

Reciprocity: The large conglomerate may have numerous opportunities for reciprocal buying arrangements.

Mutual forbearance: More generally (it is sometimes claimed) large firms treat each other with deference, avoiding competitive confrontation whenever possible.⁸⁴

Einstein and others identify a number of ways in which vertical integration affects the flow of programming. Clearly inferior shows are aired primarily because the vertically integrated media conglomerate owns them, although there is a difference of opinion on how prevalent this outcome is.

There are already many examples of network-produced programs that have failed miserably. Shows that were put on the schedule for no other reason than the network studio produced them.⁸⁵

There is definitely favoritism for internally produced shows over those produced out of house... There are limits to this.... To the extent that they won't put on a bad show that's produced internally over a good show that's not, but certainly if two shows are of equal value the internally produced show will get the nod.⁸⁶

Indeed, according to one producer, a network financial stake in a proposed series "practically guarantees" a slot in the prime-time schedule... "Without question, if I know that I am gonna lose, I just want to know that at the end of the day the shows that beat me out did so because they are better shows and not just because they're co-owned by the network."⁸⁷

More generally, owned-programming gets an inside track and is chosen when there are close calls.

[I]t appears the incentives introduced into the program selection process by the repeal of the Fin-Syn rules have clearly affected the program

⁸⁴ Asch, Peter and Rosalind Senaca, *Government and the Marketplace* (Dryden Press, Chicago: 1985), p. 248.

⁸⁵ Einstein, p. 194-195.

⁸⁶ Einstein, p. 217.

⁸⁷ Bielby and Bielby, p. 581.

selection process within broadcast networks. Specifically, the networks have an incentive to select programs produced in-house because of both financial and political reasons.⁸⁸

[I] is important to note here that internally produced programming has the so-called home court advantage when it comes to being selected for the prime-time schedule.... ‘If you put the network person in charge of both sides of the fence... It’s impossible to ask the network person to have that much objectivity.’⁸⁹

Owned programming is given better time slots.

What is less known is that the networks are selling time periods, giving the best time slots on the schedule to those who make the best deal with the network.⁹⁰

Owned programming is kept on the air longer.

Shows are also being maintained on the schedule for longer than they might be if the network did not have an ownership interest in the show.⁹¹

Owned programming clogs syndication.

A new issue has arisen in the syndication market that is adversely affecting producers to the benefit of the networks and their parent companies. Due to increased vertical integration, more and more companies are selling programs within their own company rather than going out into the marketplace to sell a show. For instance, a network that has its own production company will sell a hit show to its cable network at a below-market rate without opening the show to bidding by other outlets, cable or broadcast. Though this is very lucrative for the company, it is detrimental to the profit participants in the show—the producers, the actors and so forth. If the vertically integrated company sells the show internally, it is at a heavily discounted price, which means that the profit participants are cheated out of their rightfully earned money. By selling internally, the companies have almost created a new form of warehousing. Rather than keeping a show off the market, they are keeping the show off the market to competitors.⁹²

The pattern of acquisition of shows and movies discussed in the previous chapter also suggests that when the oligopolists are not self-supplying, they engage in reciprocal

⁸⁸ Einstein, pp. 180-181.

⁸⁹ Einstein, p. 187.

⁹⁰ Einstein, p. 217.

⁹¹ Einstein, p. 192.

⁹² Einstein, pp. 198-199.

dealing, buying shows from one another. Interviews with independent producers conducted in preparing this study indicate that, with the vertical integration of studios into the core of the oligopoly, the problem afflicts the movie segment as well. The field is simply not level.

The interviews with independent movie producers suggest that the problems that afflict independents in syndication are somewhat different for producers of series and movies. The literature on independent producers of series shows that when independents were squeezed out of the prime time series market, they simply did not have product to sell into syndication, since they were literally put out of business. To some extent, producers of movies were similarly affected, since they did not have larger budget movies to sell into syndication, though they managed to remain in the movie business. Their theatrical releases were squeezed in the syndication space as the vertically integrated entities came to dominate syndication. The squeeze was two-pronged: they found it more difficult to get placement and the license fees and other terms deteriorated.

MONOPSONY POWER

The final area of concern identified in the analytic framework is the exercise of monopsony power. The gatekeeper problem is at the core of monopsony power concerns in the video content industry.⁹³ The harm in the exercise of monopsony power is the reduction of prices paid to suppliers and therefore a reduction of the quantity or quality of the product supplied.

⁹³ Curtin, John J., Daniel L. Goldberg and Daniel S. Savrin, "The EC's Rejection of the Kesko/Tuko Merger: Leading the Way to the Application of a 'Gatekeeper' Analysis of Retailer Market Power Under U.S. Antitrust Law," 40 *B.C. L. Rev.* 537 (1999).

By reducing its demand for a product, a monopsonist can force suppliers to sell to it at a lower price than would prevail in a competitive market... If the price is suppressed they will reduce output to a level that once again equals their marginal costs. In any event, both price and output will fall below the competitive level when the buyer is a monopsonist. Some productive assets will be assigned to products that would have been the supplier's second choice in a competitive market. As a result, monopsony allocates resources inefficiently just as monopoly does.⁹⁴

This problem is evident in the TV video space as well. Broadcasters have the leverage to extract equity shares for shows not developed internally.

[I]n recent years, the networks seem to have refined their strategy even further – recognizing that when series with high potential do appear from outside producers, they can use their market power to extract an ownership stake after the pilot has been produced.

Secondarily, if the show is not internally produced, then the ability to have equity ownership in an externally produced show is expected for inclusion on the prime-time schedule.⁹⁵

Even shows in which the networks did not originally have an interest have had their financing restructured to allow the network to become a financial partner for a show to stay on air, particularly in the ever-important fifth year.... “Shakedown is probably too strong a word, but they should not have the right to insist on ownership just to provide real estate on the airwaves.”

Giving a piece of the show to the network has become a normal way of doing business since the repeal of the Fin-Syn rules, because access to the airwaves depends on giving the networks a financial interest in the program. Sometimes these requirements are subtle, like requesting that a producer create their show with their studio's production facilities, and sometimes they are quite blatant – your money or your show.⁹⁶

Of even greater concern to these producers than the perceived favoritism towards in-house production and joint ventures is an increasingly common practice by the networks of commissioning pilots from independent producers then demanding a financial stake as a condition of picking up a series for the prime time schedule.⁹⁷

Networks gain market power to meddle with the content offered by independents.

⁹⁴ Hovenkamp, Herbert, *The Law of Antitrust: An Integrated Handbook*, Hornbook Series (West Group, St. Paul, 2000), p. 14.

⁹⁵ Einstein, pp. 180-181.

⁹⁶ Einstein, p. 192.

⁹⁷ Bielby and Bielby, p. 581.

The argument being advanced here is that the increase in in-house production following the demise of the Fin-Syn Rules created a conflict of interest as business executives from the networks are placed in a position to meddle in the creative process. Under the Fin-Syn Rules, it is argued that independent producers and those affiliated with the major studios were insulated from this kind of interference.⁹⁸

Interviews with the independent film producers underscore the problem of monopsony power. The pervasive control over distribution channels on TV allows the integrated firms to dictate terms and conditions that squeeze the independents. These include license fees that do not cover the costs, given the quality that is demanded, extremely long license periods, and claims to back end-rights – home video, foreign sales and digital distribution -- that limit the ability of independents to make up for the inadequate license fees. The exercise of this monopsony power has gone so far as to allow the buyers to repurpose content to “higher” value” distribution channels without additional compensation for the independent producers. By taking a product that was purchased at terms and conditions designed for a lower value outlet and re-using it on a much higher value outlet, the vertically integrated company extracts much greater value (profit), without compensating the producer.

This exercise of monopsony power is akin to a practice that the vertically integrated companies had applied in the series space. In that space, the vertically integrated firms take a high value product and sell it at very low prices to a lower value outlet, in essence understating the value of the product, to which independent participants might have a claim.

A new issue has arisen in the syndication market that is adversely affecting producers to the benefit of the networks and their parent companies. Due to increased vertical integration, more and more companies are selling programs within their own company rather than

⁹⁸ Beilby and Bielby, p. 580.

going out into the marketplace to sell a show. For instance, a network that has its own production company will sell a hit show to its cable network at a below market rate without opening the show to bidding by other outlets, cable or broadcast. Though this is very lucrative for the company, it is detrimental to the profit participants in a show – the producers, the actors and so forth.⁹⁹

It should be evident from these examples that the existence of multiple cable outlets does not alter the already restricted television landscape because the networks have captured a substantial hold over the most important cable networks.

One way that networks are ensuring a faster return on investment is by having a secondary distribution channel usually in the form of a general entertainment cable channel. These channels are used as a secondary outlet through which they can distribute their programs.... Each of these networks present programming on the broadcast network that is then re-presented (or repurposed) on the secondary outlet. This will lead to more redundant programming and less new content through more outlets. Networks are also making their prime time programming available through video-on-demand and DVD collections.¹⁰⁰

Another increasingly popular business strategy implemented by the big four and emerging networks also offsets the impact of expanding channels of distribution. “Repurposing” involves exhibiting each episode of a series on an affiliated broadcast or cable network immediately after the initial network broadcast.¹⁰¹

⁹⁹ Epstein, pp. 198-199.

¹⁰⁰ Einstein, pp. 218-219, on the latter point Einstein cited Adalian, 2002.

¹⁰¹ Beilby and Bielby, p. 592.

VI. THE DEBATE OVER QUALITY

QUALITATIVE OBSERVATIONS

The question of the relationship between vertical integration and declining quality has been hotly debated. The exercise of monopsony power is clearly affecting the structure of the industry. Two effects have been noted.

First, the number of entities engaged in the process has been reduced sharply because the distribution of risk and rewards has been shifted in favor of the networks.

[T]he statistical patterns summarized above include instances in which the networks have used their enhanced market power to negotiate ownership shares in series pilots brought to them by outside suppliers. In these situations, the program supplier, not the network, absorbs development costs, while the network acquires a share of the back end profits if the series eventually becomes a hit and goes into syndication. From the program suppliers' perspective, the costs of development for new series remain the same, but to reach the prime-time schedule, the supplier has to agree to forgo a share of the future revenues. According to some in the industry, this revenue squeeze on independent program suppliers is the primary reason that a number of them have exited the business of prime-time series development.¹⁰²

So far, the most visible impact of deregulation has been a reduction in the number of organizational settings in which those who create television series are employed, and an increase in corporate control over the circumstances under which they practice their craft.¹⁰³

The second effect is to eliminate the creative tension that once existed between the producer and the distributor of product.

Vertical integration is seen as eliminating a valuable step in the development process. First, developing programming is a creative process. When one entity created the programming and another would select it, the two companies could argue and disagree and out of those discussions, the show would often be improved... [T]he process did favor

¹⁰² Beilby and Bielby, p. 590.

¹⁰³ Beilby and Bielby, p. 593.

internal shows and eliminated much of the development process altogether. Producers also stated that this process was detrimental to the overall quality of network programming.¹⁰⁴

One aspect of the debate over quality that is intriguing but little studied is the potential relationship between integration, declining quality and declining ratings. As Bielby and Bielby note:

In 1999, *Advertising Age* editorialized that ABC was “auctioning” its most desirable prime-time time slot to the program supplier willing to give the network a financial stake, part of a trend that is making it “increasingly clear the broadcast networks are more interested in financial deals than putting the best shows they can find on the air.” The trade publication warned that the ratings decline experienced by the networks would accelerate if “financial packages rather than program quality determine what gets on the schedule.”¹⁰⁵

The ratings decline certainly did continue, as integrated ownership of programming increased. As is frequently the case in this sector, many other things were changing that could account for the decline in ratings, but the correlation is notable.

Waterman sees some evidence of the latter effect on the studio side of the business.

[E]xcessive movie budgets and an over reliance on sequels or derivative movies have also been associated unfavorably with conglomerate organization and the mentality of the top executive in charge.¹⁰⁶

Waterman also notes that the claimed efficiency benefits of conglomeration have come into question.

When merger plans are announced, industry analysts often cite efficiencies, such as workforce combinations, or marketing advantages, such as the ability to cross-promote movies using television, magazines or other media assets also owned by the conglomerate. Also commonly mentioned are the advantages of vertical integration, such as the ownership of television or cable networks that can serve as guaranteed

¹⁰⁴ Einstein, p. 194-195.

¹⁰⁵ Bielby and Bielby, p. 581.

¹⁰⁶ Waterman, p. 30.

outlets for movies produced by the conglomerate's studio branch. A related benefit is the ability to consolidate exploitation of a single story idea or character through books, magazines, television shows, music publishing, Internet web sites, or other media within a single corporation. The economic advantages of such operating efficiencies (often called economies of scope) are plausible. However, real multimedia exploitation within the same conglomerate is apparently infrequent and other efficiency claims have come into recent disrepute – notably in the cases of AOL-Time Warner and the ABC-Disney mergers.¹⁰⁷

What we may be left with are the market power advantages of a tight oligopoly in the video entertainment space, which do not yield efficiency gains while imposing a heavy price in terms of diversity and quality.

QUANTITATIVE MEASURES OF QUALITY

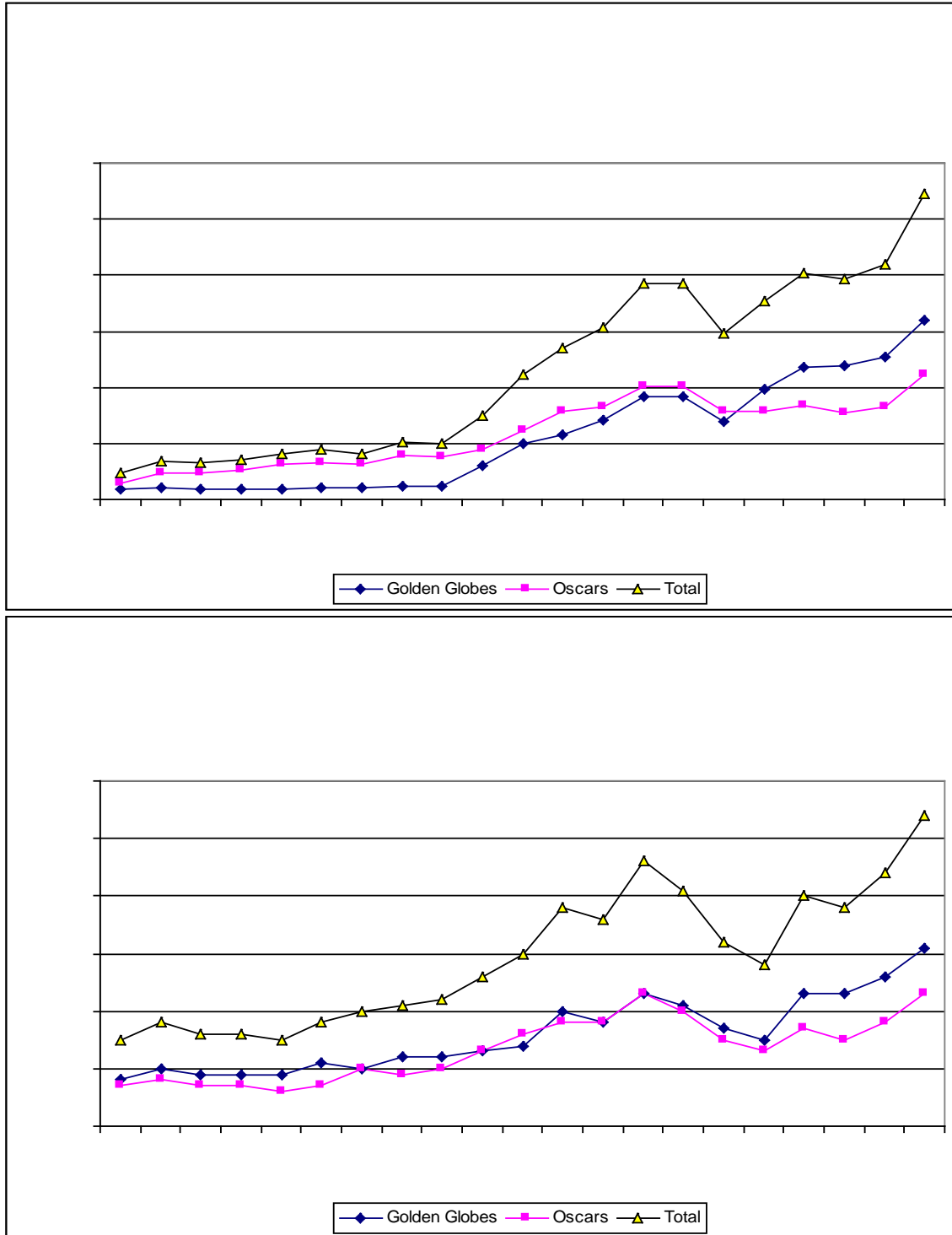
Claims that programming decisions reflect the efficient choice of the best available product are difficult to support in light of this description of the changes in behavior as well as the patterns in the data. These changes and patterns are more consistent with the argument that the vertically integrated oligopoly favors its own content and prefers to deal within the oligopoly.

Movies

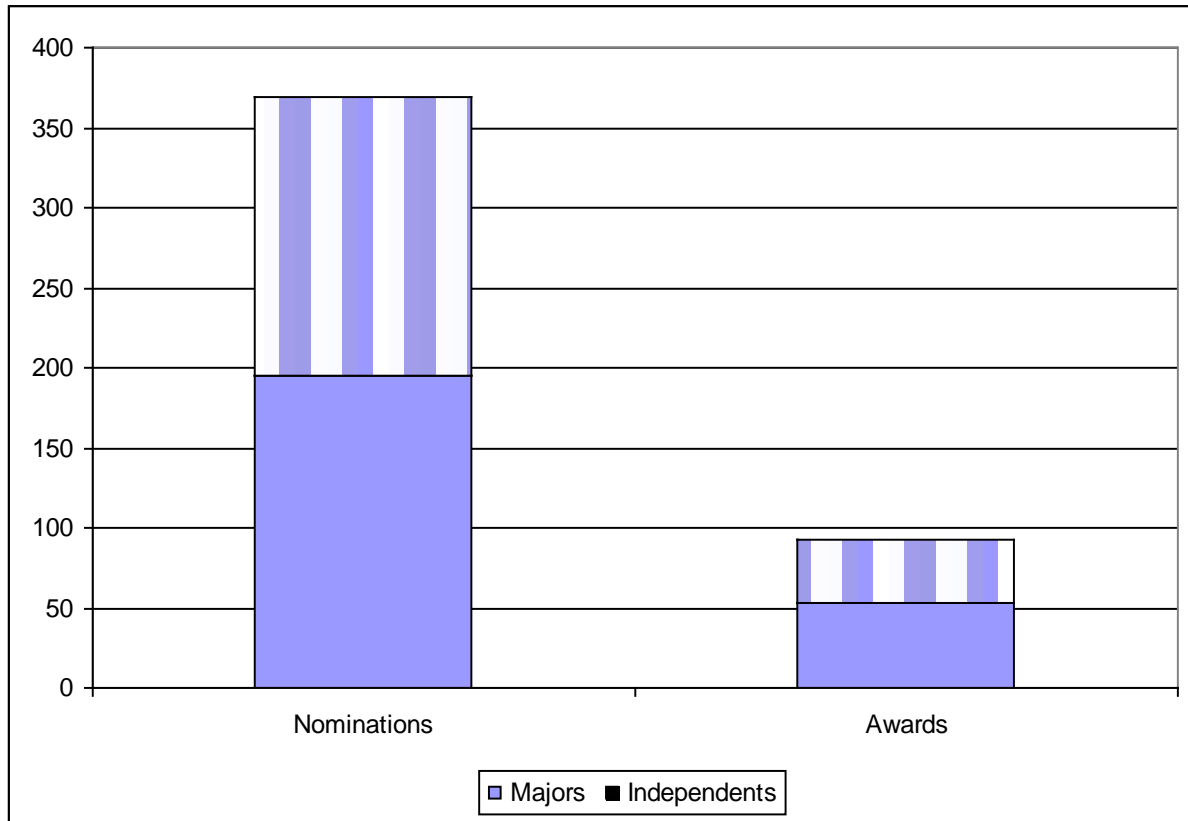
Objective measures of quality in product in the entertainment space are notoriously difficult to come by. In the movie space, analysts frequently turn to the annual awards ceremonies. The Oscars and Golden Globe Awards contradict the claim that independents suffered some sort of collapse in the 1990s. In fact, their share of awards has been constant, if not rising (see Exhibits VI-1 and VI-2).

¹⁰⁷ Waterman, p. 30; Peltier, Stephanie, "Mergers and Acquisitions in the Media Industries: Were Failures Predictable," *Journal of Media Economics*, 17(4), 2004.

**Exhibit VI-1:
Major Categories, Golden Globes and Oscars: Majors v. Independents**



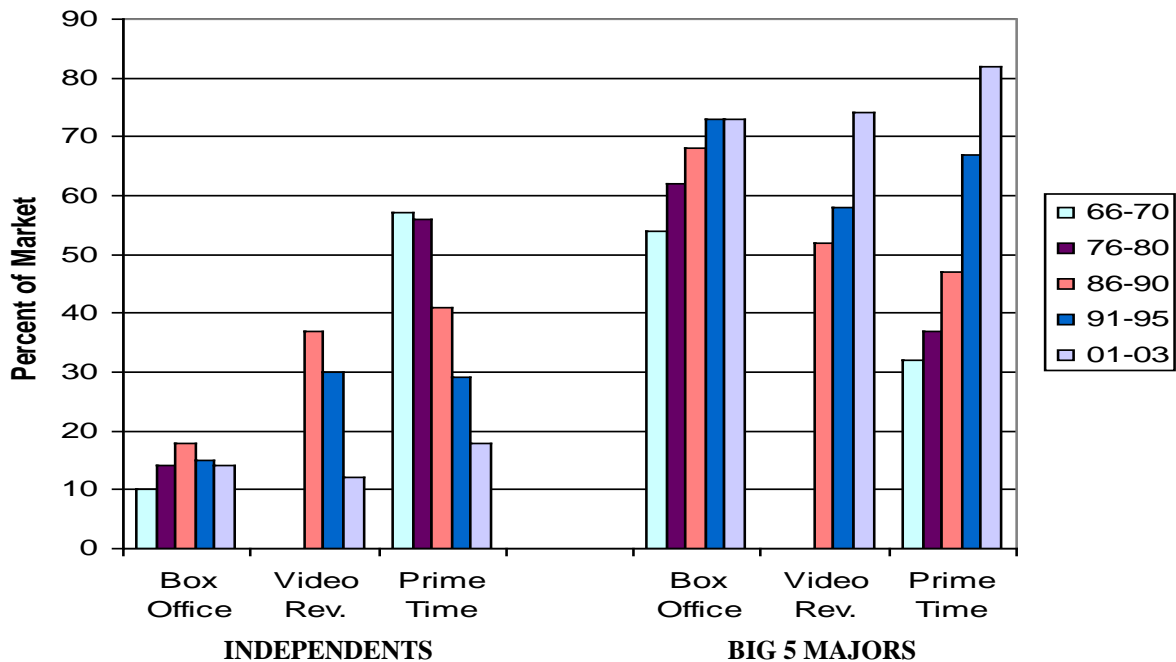
**Exhibit VI-2:
Oscar Nominations and Awards 2001-2005:
Majors v. Independents**



Source: Box Officemojo.com

Arguably, a second measure of quality is success. For movies, box office is the predominant measure, although success at the box office reflects many things beyond simple quality, such as the advertising budget. For comparative purposes across time and distribution channels, the market shares in Exhibits VI-3 and VI-4 make a simple point. Independents held their market share in the Box Office much better than they did in the other distribution channels where vertical leverage was most directly exercised.

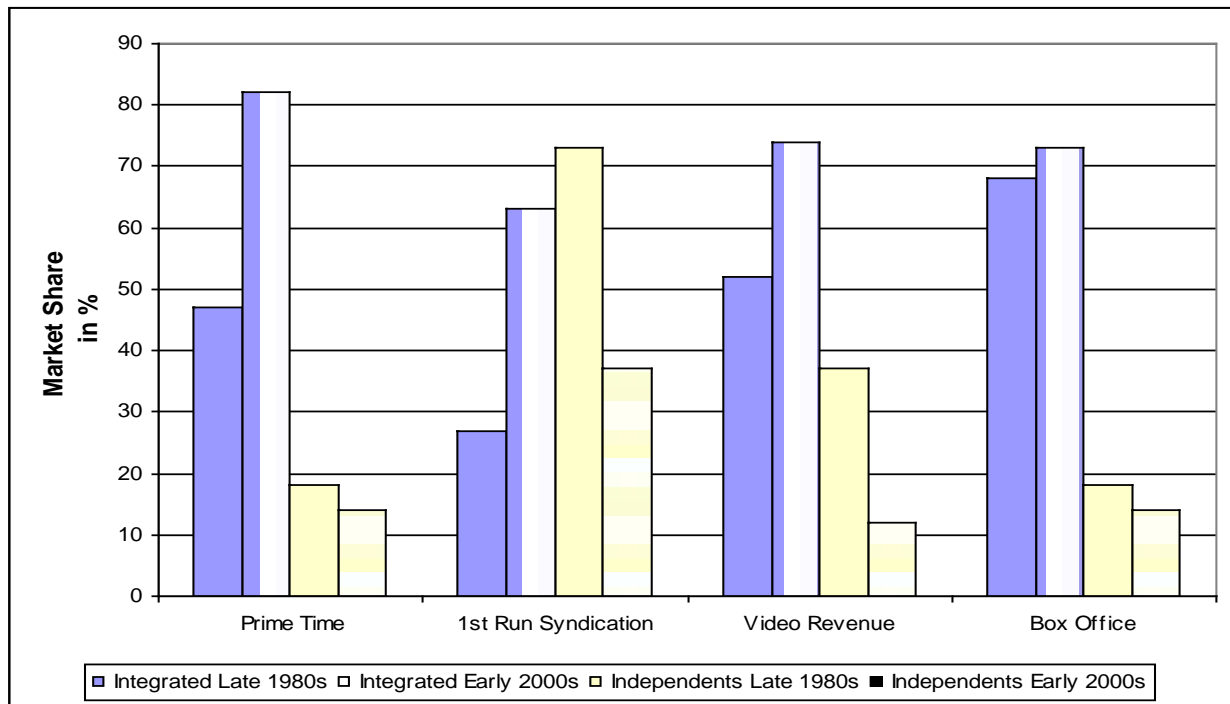
**Exhibit VI-3:
The Shares of Independent Producers in Box Office, Video Revenue
and Prime Time Hours Late 1960s to Early 2000s**



Sources. Box Office and Video Revenue are five year averages from David Waterman, *Hollywood's Road to Riches* (Cambridge: Harvard University Press, 2005), pp. 21, 25, 86-90 and 01-03. Big Five Majors are the studios that have been acquired by major TV programmers – Disney/ABC; Fox/20th Century Fox; NBC/Universal; Warner Bros.; CBS/paramount. Other majors (not shown) are MGM/UA and Columbia. Independents are what Waterman calls “the residual.” Prime Time is percent of hours in 1989, and 2002 from Mara Einstein, *Program diversity and the Program Selection Process on Broadcast Network Television* (Washington D.C.: Federal Communications Commission, September 2003), pp. 26. First-run syndication is from C. Puresell and C. Ross, “Vertical Integration and Syndication,” *Electronic Media*, 22(1): 2003, for 1993 and 2002. It includes only vertical integration and not internal dealing among the big 5.

Exhibit VI-4:

Growth of Big 5 Market Share and Vertical Integration in Domestic Markets: Late 1980s to Early 2000s



Sources. Box Office and Video Revenue are five year averages from David Waterman, *Hollywood's Road to Riches* (Cambridge: Harvard University Press, 2005), pp. 21, 25, 86-90 and 01-03. Big Five Majors are the studios that have been acquired by major TV programmers – Disney/ABC; Fox/20th Century Fox; NBC/Universal; Warner Bros.; CBS/paramount. Other majors (not shown) are MGM/UA and Columbia. Independents are what Waterman calls “the residual.” Prime Time is percent of hours in 1989, and 2002 from Mara Einstein, *Program diversity and the Program Selection Process on Broadcast Network Television* (Washington D.C.: Federal Communications Commission, September 2003), pp. 26. First-run syndication is from C. Puresell and C. Ross, “Vertical Integration and Syndication,” *Electronic Media*, 22(1): 2003, for 1993 and 2002. It includes only vertical integration and not internal dealing among the big 5.

Television

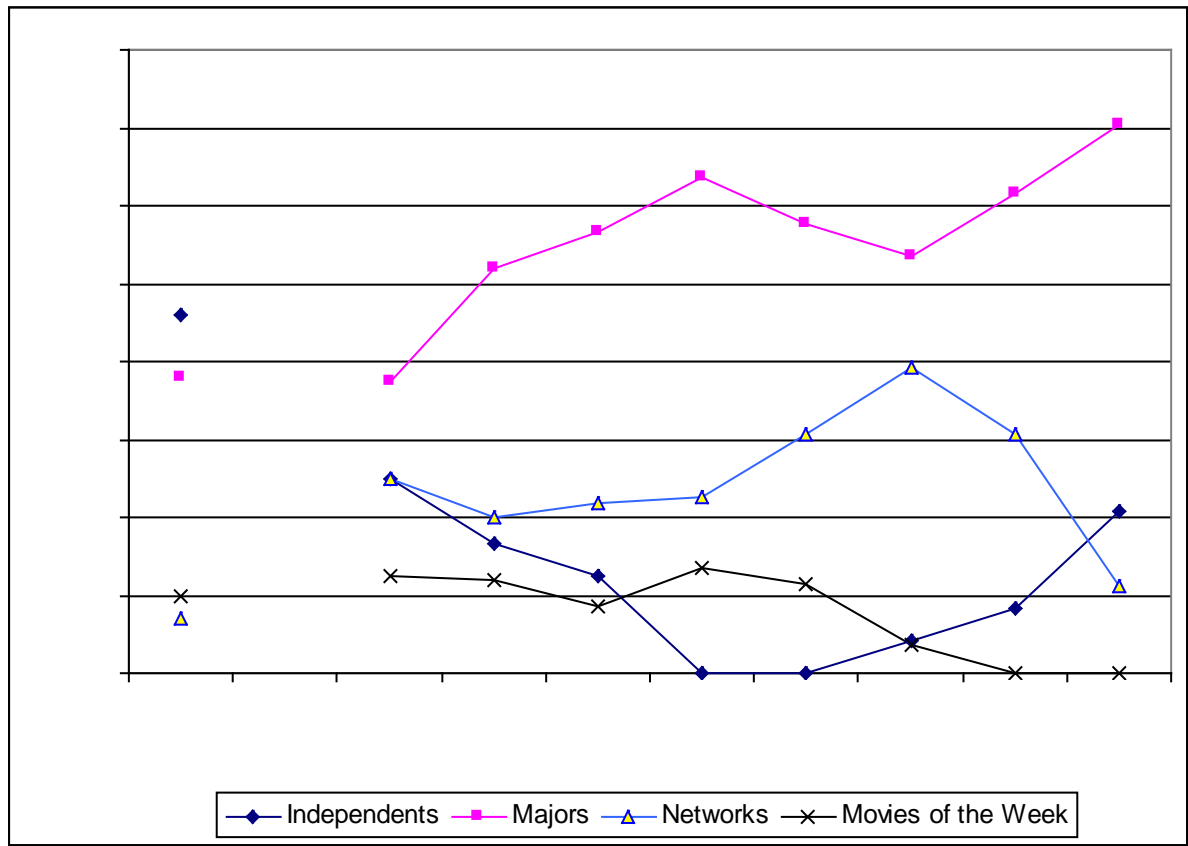
The quantitative analysis of the quality of television is even more complex.

Independents were virtually eliminated from prime time and have little opportunity to bring new product to that space, so before and after comparisons tell us little, other than the fact that they were excluded. Moreover, there is no box office to count. The essential

point here is that given the opportunity to appear in the exhibition space, independents held their own.

Exhibit VI-5 compares the source origin of the top thirty shows for two periods: 1985-1989, which is the base period I have been using for the Fin-Syn era, and 1995 to 2002 for the post Fin-Syn period. Ratings are the closest equivalent to Box Office. I start with the popularity measure because it tells us about the pattern of types of shows. I have included all non-news shows that appeared in the top 30. I have used the same coding approach as in the earlier analysis of all shows on TV. That is, where a major studio is listed

**Exhibit VI-5:
Producers of Top 30-Rated TV Shows.**



Source: Tim Brooks and Earle Marsh, *The Complete Directory to Prime Time Network and Cable TV Shows: 1946 – Present*, (New York: Ballantine, 2003), Appendix 3; Beta Study System database.

in a co-production, it is considered the producer. Where the producer uses both the name of a network and a major studio, it is counted as the major. The details of the counts might change somewhat with a different approach, but the basic patterns would be clear.

Prior to the repeal of Fin-Syn, independents and major studios dominated the top shows. The networks did not even pull their weight. They were somewhat underrepresented in these ratings. After the repeal of Fin-Syn, the vertically integrated oligopoly completely dominates the space. There are very few independents and no non-integrated majors in the top 30 shows. When the independents do return to the top 30 in the early 2000s, it is with reality shows, not scripted entertainments.

I have included the category of Movies of the Week, although I do not have the producers for the actual movies for two reasons. First, as we have seen, in the broader market share analysis, these were almost always independents and majors prior to the repeal of Fin-Syn; afterwards, they almost entirely had vertically integrated majors as producers. Second, the nature of prime time movies changed. Movies of the Week were big events with large budgets and appeared in the top 30 shows consistently, accounting for about 10 percent of the total, until the end of the 1990s. They then dropped quickly out of sight. This was the period of the expansion of Basic cable movies.

The pattern of popularity helps to provide background for the analysis of awards – the Emmys. There are a very large number of categories across many different types of shows. The categories also change over time. A separate category for Made for TV Movies was not added until the 1990s, so there is no baseline. For the purposes of this

analysis, I focus on the Emmys for Best Comedy and Drama. These are series of scripted shows, for which awards were consistently given, that most parallel movies and were available to independents.

Over the course of the 1980s there were 20 such awards given for each genre (see Exhibit VI-6). The distribution of the awards closely reflected the market share of the different types of producers. The point here is that if these awards represented an independent measure of quality, the independents held their own. The vertical restriction did not cause “inferior” products to be aired. With the repeal of Fin-Syn, independents were banished from these two categories of television entertainment and disappeared from the awards. As I have noted, their presence in prime time is now largely restricted to reality shows. The pattern of awards is similar to the other data we have seen: as Fin-Syn was under attack in the early 1990s the independents declined and were subsequently eliminated after repeal.

**Exhibit VI-6:
Emmys for Best Comedy and Drama**

<u>Producer</u>	<u>80-84</u>	<u>85-89</u>	<u>90-94</u>	<u>95-99</u>	<u>00-04</u>
Independents	70	40	20	0	0
Networks	20	40	50	100	60
Majors	10	20	30	0	40

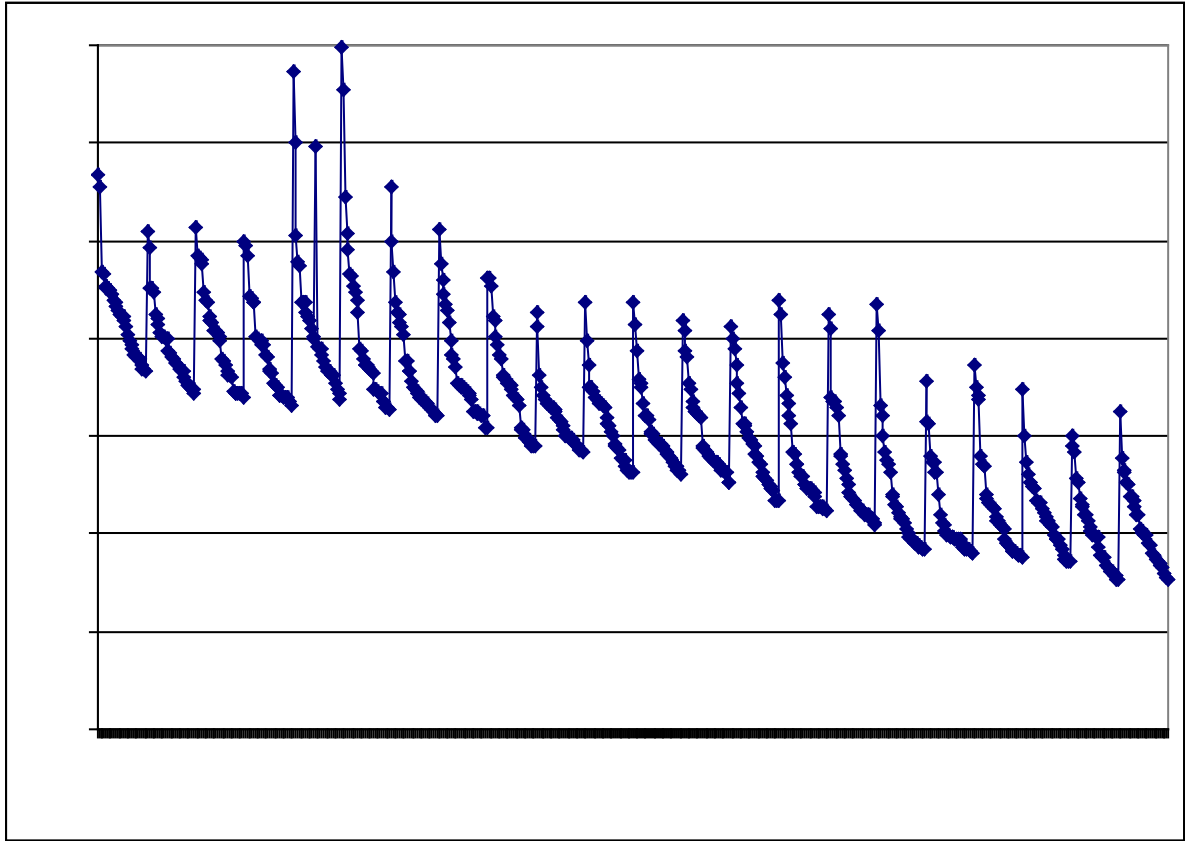
Source: Tim Brooks and Earle Marsh, *The Complete Directory to Prime Time Network and Cable TV Shows: 1946 – Present*, (New York: Ballantine, 2003), Appendix 3; Beta Study System database.

CONCLUSION

The debate over the impact of vertical integration on quality is difficult to resolve, as many factors were affecting the industry. Still, the pattern of declining ratings observed over a twenty year period is consistent with the claim that self-dealing had an

impact (see Exhibit VI-7). The Exhibit shows the average rating of the top 30 shows for each year. There are two

Exhibit VI-7: Declining Ratings of the Top 30 TV Shows



Source: Tim Brooks and Earle Marsh, *The Complete Directory to Prime Time Network and Cable TV Shows: 1946 – Present*, (New York: Ballantine, 2003), Appendix 3; Beta Study System database.

shifts downward – one in the early 1990s, as the Fin-Syn rules came under attack; one in the late 1990s and early 2000s as the integration of major studios took place. The correlation with the changing pattern of program acquisition discussed earlier is clear. While the quantitative and qualitative evidence on quality cannot prove that vertical integration was the culprit in the decline of quality, it makes a strong case that independents were eliminated not because of an inability to produce high quality and popular content, but rather as a result of a poorly run marketplace for production.

VII. CONCLUSION: PUBLIC POLICY HAS UNDERMINED SOURCE DIVERSITY, WILL THE INTERNET CHANGE ANYTHING?

VERTICAL INTEGRATION TRUMPS TECHNOLOGY

This paper has shown that the policies adopted by the FCC and Congress in the 1990s lead to a dramatic decline in source diversity on broadcast television. In the early and mid 1990s, the Broadcast networks were given three huge advantages in the television video product space. First, they were given carriage rights on cable networks (1992). Second, the Financial Interest and Syndication Rules were repealed (1995). Finally, they were allowed to own multiple stations in a single market (1996). They used this leverage to extend their control over the video content product space vertically – by merging with studios – and horizontally – by self-supplying content in broadcast prime time and expanding distribution on cable.

A tight, vertically integrated oligopoly now dominates the broadcast, cable and theatrical space in America. Promises that prime time would not become dominated by the networks, and theories that claimed competition would prevent it, have proven misguided. Hopes that cable and its expanding capacity would create vibrant competition have been dashed as the incumbent broadcaster networks extend their reach over cable's viewers by demanding carriage and extending their brand control into the new space. While the purpose of this paper is to document what happened and why, it is clear that if policymakers still believe in source diversity, then a change in policy to promote it would be in order.

Previous technological changes have not been able to deconcentrate the product space. It has taken policy changes to break the stranglehold on distribution. Whether theaters in the 1940s or broadcasters in the 1970s, gate keeping has long been a powerful force in the industry.

Because of the high cost of producing movies and other video content, the aggregation of audiences remains a critical function. With such a powerful hold on all forms of video distribution, it will be extremely difficult to dislodge the dominant players. They are the established brands and continue to gain momentum in the premium, large audience outlets.

THE INTERNET AND DIGITAL BROADCAST PLATFORMS

While the history of the video entertainment product space is clear, as is the basis for adopting policies that promote source diversity, there is no doubt that policymakers who contemplate adopting such policies will be bombarded with claims that, even though the policies that affect the traditional video distribution channels have been disastrous, we need not be concerned because ‘the Internet changes everything.’

This claim should be viewed with a great deal of skepticism. In fact, the more likely question that policy makers in this area should ask is “Do the Internet and the new digital era change anything?”

The best assessment at present is that “only a few small experiments in altering the movie-release paradigm have been conducted to date.”¹⁰⁸ While the role of the Internet is currently unclear, one thing is certain. It is another distribution platform that the vertically integrated conglomerates are moving to dominate. Whether it will be able

¹⁰⁸ Thompson, Anne, “Independent Producers and Distributors,” *Hollywood Reporter*, August 1, 2006, p. 1.

to de-concentrate the video exhibition space described in this section remains subject to debate. However, without sufficient regulation that provides equal access to all, the Internet will fall subject to the same fate as broadcast television, premium cable television, and finally basic cable television: domination by the vertically integrated oligopoly created by the regulatory changes of the last decade.

As we have seen, in a world with limited shelf space, placement is everything. If you cannot get on the shelf, the audience cannot find you. In a world of infinite shelf space, placement is still everything. When there is such a cacophony of outlets, the audience cannot find you unless you have prominent placement. Whether it is simultaneous release on multiple platforms or widespread digital distribution, the key challenge remains “finding a way to brand a movie.” In the end, says producer Jim Stark, “Nothing beats five weeks in a theater.”¹⁰⁹

One need only review the critique of the launches of new Internet-based distribution platforms to see the problem in clear relief. The central questions are: what do their libraries look like? What are the majors doing with respect to the platform? If the majors are not there, the platform is deemed to have dim prospects. When the majors and networks are there, they tend to get the best placement and the best deals. Little has changed. They are the most prominent and have the resources to preserve that prominence. This is clearly reflected in the reporting on the announcement of Apple’s “video streaming gadget code-named ITV”¹¹⁰

Apple’s competition included the movie studios themselves plus many other ambitious firms such as Amazon, which recently unveiled its Unbox download service.

¹⁰⁹ Thompson, p. 1.

¹¹⁰ Ward, Mark, “Apple Video Divides Industry,” *BBC News*, September 13, 2006, p. 1.

TV shows are also starting to turn up the online service for Microsoft's Xbox...

Apple pre-announced its ITV box in a bid to convince potential partners that its ambitions are serious... it hoped to build "momentum" and get movie makers and broadcasters talking about putting content on the Apple service. For example, Amazon's Unbox offers movie downloads from 20th Century Fox, Paramount, Sony, Universal and Warner Bros. So far, only Disney movies are available from Apple.¹¹¹

The quote from Les Moonves of CBS above, which touted the advantages that broadcasters have, was actually given in response to claims that the Internet was displacing the networks. Responding to the claim that broadcast share would shrink, Moonves said "If you want 30 million people, you can't get that anywhere else...Television will hold and the Internet will augment what we do."¹¹²

Dana Walden of 20th Century Fox TV echoes this view. "In the digital space, the extensions seem to come after the fact. We're trying to create brands on the (broadcast) networks that are enhanced by digital opportunities."¹¹³

While the potential and prospects are unclear, the reaction to a new technology is predictable and the studios and networks will seek to extend their gatekeeper function. Already, as one recent article observed, "studio business affairs executives now were insisting that this exclusivity [in rights to distribute] include the Internet as well."¹¹⁴

Thus, the Internet has not done much to break the grip of the vertically integrated oligopoly on the video revenue streams in the video entertainment product space. As the independent producers emphasized in the interviews, these firms control the TV outlets and syndication, have the output deals for domestic and foreign theatrical releases, and

¹¹¹ Ward, p. 2.

¹¹² Fabrikant and Carter, p. C11.

¹¹³ "A TV Navigation Guide," *Hollywood Reporter*, September 13, 2006, p. 2.

¹¹⁴ Hlestand, Jesse, "Profit Anticipation," *Hollywood Reporter*, June 6, 2006, p. 1.

have a huge advantage in foreign TV deals. They control the branding process with their access to audiences that is being leveraged into dominance of commercial distribution on the Internet.

Given the history of gate keeping in the industry and these observations on the impact of Internet distribution, the advent of digital TV, which will increase the number of channels the broadcasters control as much as six fold, does not hold much promise to deconcentrate the TV sector. Broadcasters, who have leveraged a series of favorable policies into domination of the video entertainment product space, will now have more resources to strengthen their position, enrich their brands and repurpose their content across another distribution channel. Technological change and an increase in distribution capacity have repeatedly failed to restrict the gate keeping power of vertically integrated entities in this product space.

CONCLUSION

If policymakers value source diversity, which they should, structural restraints on the market power of the vertically integrated companies will have to be imposed. These structural restraints will have to apply to both the broadcast and cable distribution channels because public policy created the leverage that broadcasters have used to dominate the cable distribution platform. The restraints should also apply to the Internet and all other developing distribution technologies.